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What is I.D.P.?

A Review of the Sales Tax Report

Records Retention and Destruction

Grain Accounting for Western Canada

Taxation of Canadian Oil and Gas Companies

Professional Ethics


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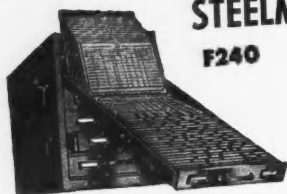
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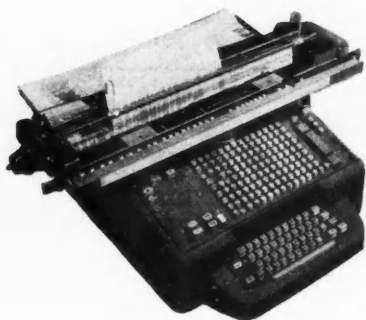
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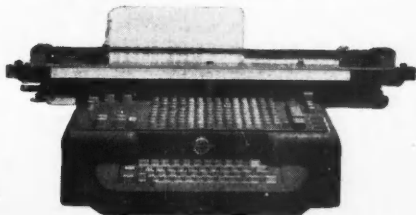


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THE CANADIAN CHARTERED ACCOUNTANT

VOL. 68, NO. 6, JUNE 1956

EDITORIAL

Annual Conferences and the Profession 469

ARTICLES

What is Integrated Data Processing?

Kenneth M. Place 471

Taxation of Canadian Oil and Gas Companies

D. A. McGregor 477

Professional Ethics

Denis Goodale 483

Grain Accounting for Western Canada

Walter J. Macdonald 489

A Review of the Sales Tax Report

H. O. Spindler and D. R. Huggett 501

Records Retention and

Destruction *John A. Orr* 506

DEPARTMENTS

Administrative Accounting 513

The Tax Review 517

Current Reading 521

Students Department 527

MONTHLY FEATURES

In This Issue 456

Notes and Comments 462

News of Our Members 539

Institute Notes 540

Sweetness and Light 541

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IN THIS ISSUE

WALTER J. MACDONALD, F.C.A.

Some months ago it was suggested that a series of articles on grain accounting might be written for the magazine. Grain is a prime factor in the Canadian economy and while its accounting principles are much the same as those which govern other types of trading, the particular application of these principles is marked by some notable differences.

In "Grain Accounting for Western Canada" by Walter J. Macdonald, the author has endeavoured to outline some of the reasons for these differences. The whole approach to the subject is based on his own first hand knowledge of the industry covering a period of more than 37 years. After spending the early part of his professional career as assistant auditor of The Canadian Wheat Board, Mr. Macdonald started his own firm of Millar, Macdonald & Company and from 1921 to 1930 was the auditor of the Board of Grain Commissioners for Canada. In 1924 the firm became auditors of the Manitoba Wheat Pool and a year later undertook the audit of Manitoba Pool Elevators which appointment has continued to the present time. Since 1935 Mr. Macdonald has been the auditor of the Canadian Wheat Board. During World War II he served for a time as controller, Department of National Defence for Air. He is a past president of the Canadian Institute of Chartered Accountants. We feel sure readers will be equally interested in the remaining articles which will be published

in forthcoming issues. All the contributors to the series are eminently qualified to write on their particular subject.

D. A. MCGREGOR, C.A.

In the years that have passed since oil was discovered at Leduc and Redwater in Alberta, the Canadian oil industry has expanded considerably, and one of the major problems which continually faces it is the question of taxation.

In D. A. McGregor's article "Taxation of Canadian Oil and Gas Companies", the author deals with legislation and exploration expenses and discusses present regulations of the Income Tax Act in regard to the definition of oil operators. Mr. McGregor has been with Clarkson, Gordon & Company since 1944. He moved to Western Canada in 1949 and is now a partner of the firm in their Calgary offices. He is a member of the Institute of Chartered Accountants of Alberta and the Petroleum Accountants Society of Western Canada. He is also a Governor of the Canadian Tax Foundation.

KENNETH M. PLACE, C.A.

Trade publications and business journals in recent years have been almost overloaded with articles on "push button devices". This has left people in a bewildered state of mind and open to serious misunderstanding of the subject. One result has been that management in the past has placed far more importance upon the installation of automatic machines to improve production efficiency than it has upon the application of mechanization to improve office efficiency. In Kenneth M. Place's article "What is Integrated Data Processing?", the

Continued on page 458

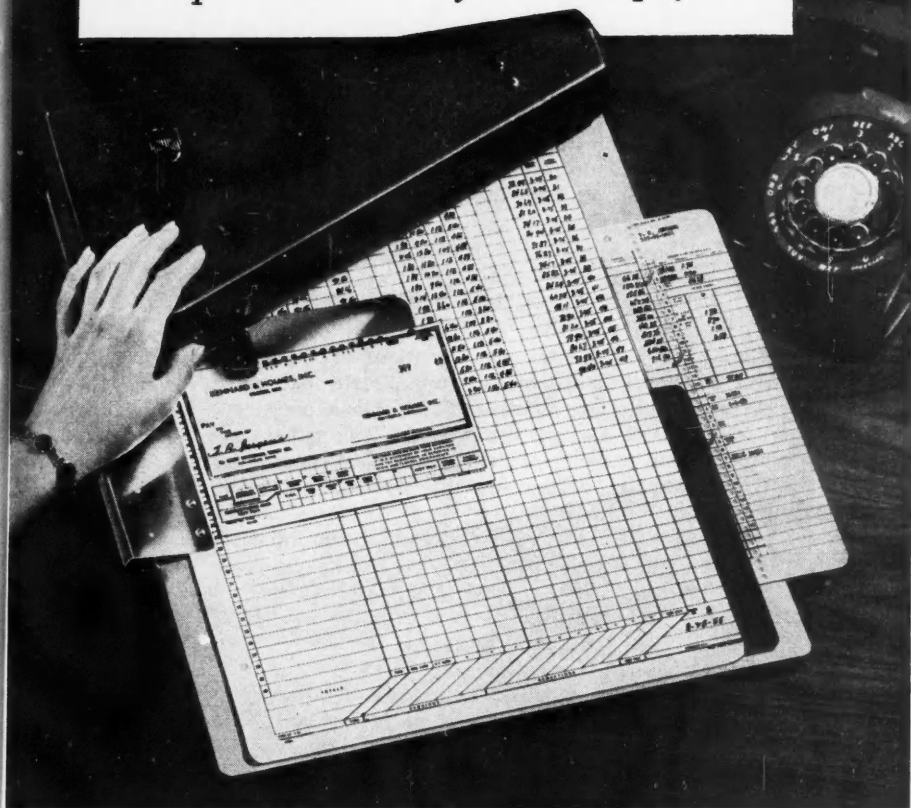
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author clears up a lot of loose thinking and gives some very specific examples of its effectiveness, particularly in relation to electronic data processing. As Mr. Place told the Editor: "It has been suggested that considerable time will elapse before widespread application of I.D.P. is possible. Automation in the office, however, must keep pace with automation in the plant. Only in this way will the full benefits of both be realized."

Mr. Place has been engaged in a study of the subject for a considerable time. A graduate of McGill University, he joined Canadian Industries Limited in 1946 after war service with the Royal Canadian Air Force. He is presently first assistant treasurer of Du Pont Company of Canada Limited and is editor of this magazine's bi-monthly department "Administrative Accounting". Besides being a chartered accountant, he is a member of the Controllers Institute, the National Association of Cost Accountants, the American Management Association and the Montreal Chapter, Society of Industrial and Cost Accountants. He is also a member of the Canadian Manufacturers' Association.

H. O. SPINDLER, C.A. and

D. R. HUGGETT, C.A.

The appointment of a committee to review and advise upon certain technical questions relating to the administration of the sales tax was announced by the Minister of Finance in Parliament last July. In January of this year, the committee completed its report. Visits were made by members of the committee to Washington, D.C. and to Australia, and 31 organizations presented submissions. Soon after the report was published

authors Spindler and Huggett prepared a review of the main recommendations contained in it. Mr. Spindler and Mr. Huggett have both been associated with McDonald, Currie & Company in Montreal for the past four and five years respectively. Mr. Spindler is a graduate of McGill University while Mr. Huggett graduated from Queen's University in 1951 with B.A. and B.Com. degrees. He obtained his C.A. certificate in 1954.

JOHN A. ORR, C.A.

Most accountants are naturally cautious and conservative and tend to accumulate old records until they have filled every available storage space. This makes John A. Orr's article "Records Retention and Destruction" timely and a particularly topical subject. "Perhaps", says the author, "we should begin by switching the emphasis from the clean desk to the full waste-paper basket". Mr. Orr describes the various steps to be taken before discarding documents and how best an orderly records program can be worked out from the time of creation to ultimate disposal or transfer to permanent storage.

John Orr is a partner in the Toronto office of George A. Touche and Company and obtained his certificate in chartered accountancy in 1951. He is a member of the Institute of Chartered Accountants of Ontario and is presently serving on its public relations committee.

DENIS GOODALE, C.A.

The accounting profession has gone a long way towards gaining general public confidence and the continuation of this state of affairs depends

Continued on page 460

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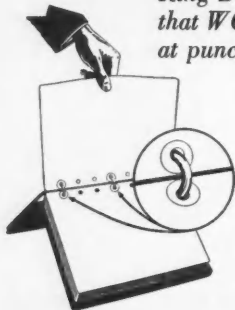
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Continued from page 458

upon a combination of technical competence and a keen recognition of professional moral obligations. In Denis Goodale's article "Professional Ethics", the author examines some of these special obligations under the rules of professional conduct to see how they stand up to present day circumstances and meet the best interests of the public whom the profession wishes to serve. Up to now, the record would seem to be amazingly good but, as a fast growing profession, there is always the possibility of falling heir to many of the difficulties which older professions have had to face during their development.

Denis Goodale is currently Associate Professor of Accounting at the University of Alberta. In 1949 he became a member of the Institute of Chartered Accountants of Saskatchewan and in 1952 was admitted to membership of the Alberta Institute of Chartered Accountants.

FORTHCOMING FEATURES

S.E.C. IN RELATION TO CANADIAN
ACCOUNTANCY
G. K. Carr

ADVERTISING AGENCY OPERATION AND
CONTROL
D. W. Turnbull

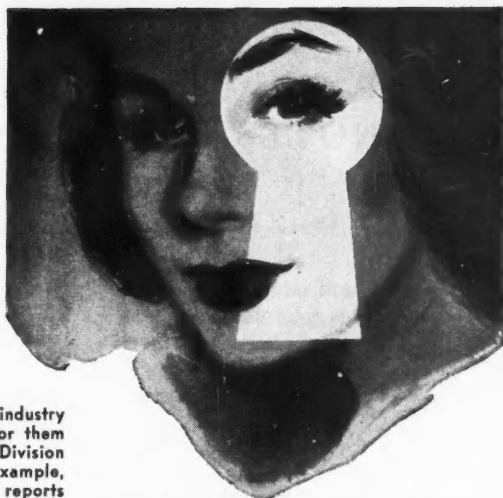
A LOOK AT DEPRECIATION AND
INCOME TAXES
J. W. Crowe

OSCARS — CONSOLIDATION FOR THE
LOSERS
Howard I. Ross

THE C.A. AND THE UNAUDITED
STATEMENT
A. Beedle

COUNTRY GRAIN ELEVATOR
ACCOUNTING
W. C. MacDonell

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NOTES AND COMMENTS

Glad Tidings

Professional and other self-employed people on this side of the Atlantic are filled with new hope for their own cause on learning that the 1956 U.K. Finance Bill contains a provision to allow their British counterparts to save for retirement on a tax-free basis. Briefly this provision will enable the self-employed, directors of companies and employees not already members of an approved pension scheme to deduct for income tax and surtax purposes a "qualifying premium" of up to 10% of earnings each year, or £500, whichever is less. Such premiums are payable to an insurance company or a trust fund to secure a non-commutable and non-assignable life annuity. Each annuity contract must be approved by the Inland Revenue.

This piece of legislation, which affects an estimated 9½ million people in the United Kingdom, will be discussed in more detail in a later issue of this journal.

Scottish Report on C.A. Training

Changes termed "revolutionary" have been recently recommended by a Special Committee on Examination and Training of Apprentices of the Scottish Institute of Chartered Accountants, according to the report of Sir Ian Bolton, that Institute's president. The committee, set up in February 1953 under the convenorship of Thomas Lister, advocates:

1. Recasting of the examination syl-

labus so as to introduce an Institute examination in five parts, one of which would be taken during each year of the apprenticeship study.

2. Linking of the apprentice's program of study with the university years.
3. Providing that prescribed university classes in law, accountancy and business method should be taken together during an academic year of approximately nine months, for which time the apprentice would be granted leave of absence from his master's office.

The "academic" year, normally the third year of a five-year apprenticeship, would be counted as part of the period of indenture.

Recognizing that these proposals, if implemented, would be breaking fresh ground in the system of training accountancy students, the Scottish Institute will shortly submit them to a special general meeting of its members for their endorsement.

May Meeting

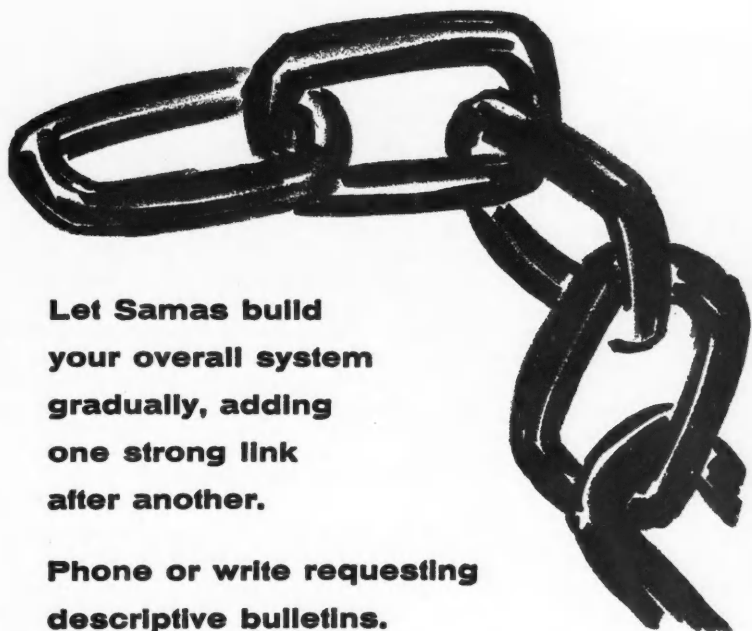
The Executive and Council of the C.I.C.A. held their main business meeting at The Briars, Jackson's Point, Lake Simcoe from May 26 to 30.

1956 Uniform Examinations

The 1956 intermediate and final uniform examinations of the Institutes of Chartered Accountants in

Continued on page 464

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Continued from page 462

Canada will be held from October 10 to 17. Morning sessions will be from 9 a.m. to 1 p.m. and afternoon sessions from 2 p.m. to 6 p.m. The timetable is published on page 538 of this issue.

C.I.C.A. Research Meeting

A full meeting of the Committee on Accounting and Auditing Research will take place at Mont Gabriel, Quebec on June 5 and 6 under the chairmanship of H. P. Herington.

To Serve Investors

International Investment Quarterly, the world's first periodical specializing in discussion and information about international investment of private capital, has recently commenced publication. Aimed at serving the North American investor, the quarterly will devote itself to articles, reports and other material concerning the movement of capital from one country to another. It is published at Toronto by Harley D. Potter, formerly a member of the editorial staff of *The Financial Post* and a reporter on the *Winnipeg Tribune*.

Eaton Nominated

The Council of the American Institute of Accountants has nominated Marquis G. Eaton for its 1956-57 president. Mr. Eaton is a partner in the firm of Eaton and Huddle, San Antonio, and a past president of the Texas Society of Certified Public Accountants and of the Southern States Accountants Conference.

Nominated for vice-presidents were William S. Deeming, Chicago; Louis H. Penney, San Francisco; Donald P. Perry, Boston; and R. Warner Ring, Miami; and for treasurer John B. Inglis, New York.

Scottish Institute's New President

George Innes Stewart, M.C., C.A. has been elected president of the Institute of Chartered Accountants of Scotland for 1956-57. He is senior partner of Messrs. Martin Currie & Co., Edinburgh. During World War II, he was attached to the Bank of Canada, Ottawa, acting as the Canadian agent of the Bank of England in connection with the repatriation of Canadian securities held by United Kingdom residents.

Members of the C.I.C.A. will have an opportunity to meet Mr. and Mrs. Stewart when they attend the 1956 annual conference at Halifax in September.

Improvement Program

The 7th annual progress report on the Joint Program to Improve Accounting in the U.S. Government was released last month. Improvements to be made in the current year include the installation of an electronic system for processing 350 million cheques drawn on the Treasury and reconciling them in the General Accounting Office. The new system will produce annual savings of more than \$2 millions.

In the News

DR. CHESTER S. WALTERS, C.A., former comptroller of finances for Ontario, was awarded an honorary Doctorate of Laws by the University of Toronto at its spring convocation on May 25.

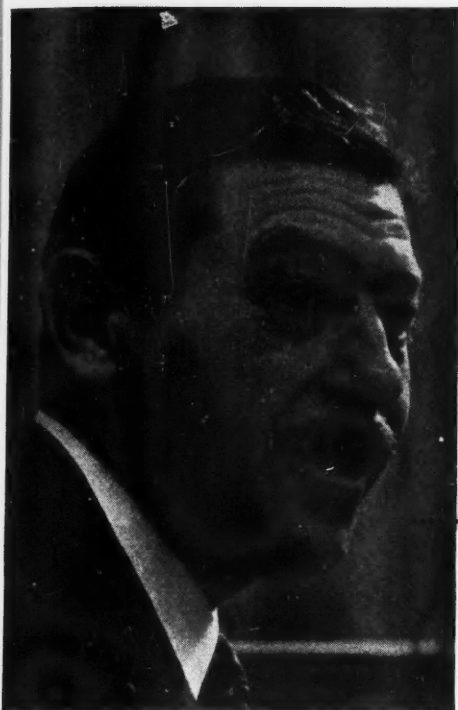
EINAR GUNDERSON, C.A. has been appointed executive vice-president of the Pacific Great Eastern Railway, owned by the B.C. Government.

PERCIVAL F. BRUNDAGE, a past president of the American Institute of Accountants, was sworn in as director of the Bureau of the Budget at the White House on April 2, Mr. Brundage's 64th birthday.

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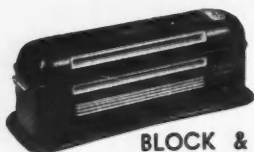


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ANNUAL CONFERENCES AND THE PROFESSION

E. MICHAEL HOWARTH, *C.I.C.A. Executive Secretary*

IN 1953 THE CANADIAN Institute established a standing committee charged with the task of planning a program of technical sessions for its annual conference. During the past few weeks a preview of the program for the conference being held in September at Halifax has been received by all members of the Institute. As this will be the third conference since the establishment of the committee, it might be worthwhile to appraise the progress made and to consider some of the general aspects of our present system of annual conferences.

At the outset it can be confidently stated that the committee has successfully achieved its prime objective, namely, the provision of an expanded program of technical sessions of interest to all major elements of the profession. At both Winnipeg and Toronto, the attendance, participation and comment of members left no doubt that the committee was on the right track. Experience gained on these two occasions, however, suggests that no cut-and-dried formula for a successful program exists, and the committee must be prepared to improvise and innovate within the broad framework which has been established.

Planning a program of this kind always presents a number of problems, not the least difficult being the attainment of a satisfactory balance in the choice of topics. There has been a conscious effort to provide for some of the more specialized interests of both practising and industrial members, but, surprisingly enough, some of the sessions deliberately slanted at one group have been well attended by representatives of the other. Apparently our members welcome the opportunity to become better acquainted with problems and techniques not necessarily a part of their everyday concern. While recognizing these special areas of interest, the committee has borne in mind that the more fundamental problems facing the profession are common ones. This is reflected in the inclusion in this year's program of such subjects as education, postgraduate training, and human relations.

It might be feared that undue stress on broad, basic themes

would relegate matters of pressing local concern to a background role, thus destroying what is potentially one of the most fruitful areas of a national conference. A conference should focus the attention of visiting members on local professional problems. From the resultant exchange of ideas, both visitors and hosts benefit, and our conference would certainly be the poorer if this important feature were excluded or seriously neglected. Striking a happy balance is not an easy matter, but provision for discussion groups should certainly offset any tendency towards what for some may seem an overdose of interesting but rather remote issues.

These sessions have proven among the most popular of recent conferences. In a pleasant university atmosphere, a variety of topics are keenly debated in a spirit of friendly give-and-take. Subjects are deliberately chosen for their wide appeal, and every encouragement given to the expression of views based on personal experience. Augmented by many opportunities to chat informally, these sessions also serve as a very useful sounding-board, by bringing into prominence those matters towards which the thought and efforts of the Institute's staff and committees should be directed.

Turning now to a more general consideration, it is worth noting that, despite the rapid growth of our profession in recent years, we are still able to accommodate a national conference in each of our ten Provinces. The day may come when only a few of the largest cities will be suitable, a point already reached in the United States where the conference of the American Institute of Accountants is supplemented by a series of regional conferences throughout the country. Regional conferences can make a valuable contribution, but they are no adequate substitute for a national conference which brings together members from all parts of Canada and enables each Institute in turn to act as host to its brother members.

One very important result of our type of conference, and one frequently overlooked, is its effect on local members. It has been the experience in more than one Institute that an *esprit* has been established which has continued to flourish long after the conference itself has passed. In particular, the stimulus to younger members has been noted. For many of them, membership on a conference committee marks their first active participation in Institute affairs, and the enthusiasm aroused pays important dividends in subsequent years. Association with a successful conference is not without its effect on the community and this, in turn, is reflected in a heightened professional awareness on the part of those involved. Whether or not a conference can be termed successful will of course depend upon the standards adopted by those forming an opinion, but in the eyes of the public the interest shown by the members of a profession is usually the sole criterion. By their participation, whenever possible, our members can find much of value to themselves, while at the same time enhancing the profession they serve.

What is Integrated Data Processing?

KENNETH M. PLACE

ONE OF THE first uses of the phrase "integrated data processing" (IDP) was at an American Management Association Conference in New York in February, 1954. In the past two years, however, many volumes have been written on the subject and this new term has been seized upon by business machine manufacturers as a means of promoting the sale of their products. The use of the phrase on such a widespread basis has undoubtedly created a considerable amount of misunderstanding and confusion in people's minds, particularly those not directly concerned with the processing of business data. Much of this confusion and misunderstanding would not have occurred if the emphasis had been placed upon the principles involved instead of on the machines required to implement them.

Webster defines "integrate" as "to combine (parts) into a whole". Thus when a typewriter produces a punched card which can be used in a tabulating machine, the two machines may be said to be integrated. Integrated data processing is therefore really nothing new but rather a coordination of various systems for the handling of paper work by means

of mechanical methods. In the process of coordination and integration the drudgery of routine clerical operations is put on machines and the major clerical functions consist of programming and analyzing rather than transcribing and recording. There can be no doubt that management in the past has placed far more importance upon the installation of automatic machines to improve production efficiency than it has upon the application of mechanization to improve office efficiency. It is now evident, however, that equal importance must be given to increasing efficiency in the processing of business data in order to realize the full benefits of the automation of production equipment.

Reducing Repetition

Before duplicating and mechanical methods were available, data were recorded and transcribed as many times as required in order to complete the business cycle. One of the earliest attempts to reduce the repetitive writing of data was through the use of carbon paper making it possible to create several exact copies of an original document and thereby eliminating copying and errors in transcribing. More recent develop-

ments include (a) one-write systems such as might be used in a payroll operation whereby the writing of a payroll cheque would cause the proper information to be recorded on an employee earning statement, payroll register etc., (b) bookkeeping machines, (c) punched card tabulating machines, etc. And so we have progressed from one stage of development to another and have finally reached the concept of "Integrated Data Processing".

What, then, have been the factors contributing to the tremendous amount of interest in the subject during the past few years? In order of importance, they are the following:

1. *Management needs far more timely information concerning sales, production and financial results.*

Since the end of World War II we have gone from a seller's to a buyer's market and into a period of intensive competition. Customer service and prices are therefore of paramount importance and every opportunity to improve service and reduce costs must be developed to the full. While historical information has a value, management today has to make decisions faster and sound decisions can be made only if the information which is available to management is current.

2. *Increased paper work*

The amount of paper work has increased at a substantially faster rate than the general level of business. While management requires more information than heretofore, there has been a tremendous increase in the amount of paper work due to the demand of all levels of government for special reports and statistics of all kinds.

3. *Increased clerical costs*

In the past the conventional approach to the paper work problem has been to add more clerks. However, the point has been reached where the mere addition of clerks is not the solution to the problem and clerical costs have increased out of all proportion to direct costs.

After having tried all the previously developed means of reducing clerical costs while at the same time handling a larger volume of data more rapidly and having met with only limited success, businessmen generally have realized that some new technique must be developed. Hence came the "integrated data processing" approach as it is known today.

Three Conditions

"Integrated Data Processing" is based on the following three conditions:

1. Original data are recorded at their point of origin in a manner capable of mechanical processing.
2. Once in this form, these data are processed exclusively in a mechanical manner.
3. All processing data are integrated so that original data in mechanical form serve all subsequent applications.

In order to obtain the maximum benefits from integration, it is first of all necessary to study the implications of the system from an overall company viewpoint rather than from a divisional or departmental level; to expand and coordinate the piece-meal office mechanization which has developed over the years. One of the basic reasons for the tremendous increase in paper work and consequent

increase in clerical costs has been the failure to attack the problem from an overall viewpoint. Instead most attempts directed towards works simplification and the use of mechanical applications have been made on a limited basis; for example, individual systems were established for the sales office, the manufacturing unit, the accounting department, etc. Individually, each unit could conceivably possess a fairly efficient operation, but collectively the system was not capable of producing quickly all of the information management required for efficient administration.

It has also been found that information prepared by one segment of an organization might not necessarily satisfy entirely the requirements of another so that it is inevitable that there will be a considerable amount of duplication in both the type of records being maintained and in the information being reported throughout the system.

Common Language

When an integrated data processing system is used the unreliable human element of transcribing from one medium to another can be completely eliminated at all key operating points. In order to integrate or combine several unrelated machines into an efficient errorless data processing system it is necessary to have a common language to replace the various languages used by different machines. The medium by which one machine directs another has come to be known as "common language".

Initially five channel punched paper tape was selected as the "common language" because this medium

was common to more different types of machines than any other and had performed reliably for many years in teletype systems. Perhaps it is most widely used because of the communication problem created by the decentralization of business. There was a time when the usual corporate organization was a closely knit affair with head office, sales office and production facilities at one location. The trend during the past few years has been in reverse so that a good communication system is essential if information is to be transmitted throughout the organization promptly. Punched paper tape can be used for transmitting data by teletype and can be used by a number of types of equipment. Through the medium of a tape-to-card converter, the data contained in a tape can be converted into punched card data. In any event the significant characteristic of integrated data processing is not the use of any specific common language but rather the automatic perpetuation of repetitive data.

Steps in a Typical Problem

A typical example of an integrated data processing system in operation will serve to demonstrate the scope and possibilities. For purposes of illustration let us assume that the sales office, manufacturing unit and head office are at different locations and that all are connected by a teletype system.

Generally the first approach to integrated data processing is made in the handling of sales orders. The information on the order is probably the most widely used information in the business process. A logical approach to the problem would be as follows:

- (a) Upon receipt of a customer's order in the sales office, it is sent to a teletype machine equipped with tape reading and punching mechanisms. An order acknowledgment set is prepared on the sales office teletypewriter machine which simultaneously prepares a copy of the order including a bill-of-lading set on a teletype received located in the manufacturing unit. A pre-punched master tape for each customer containing all the repetitive information can be used in the tape reading mechanism to automatically type the repetitive information. A tape punching attachment can also duplicate all of the information contained in the order acknowledgment for later use in the invoicing operation.
- (b) After the shipment has been made the order can be completed as to quantity shipped and value.
- (c) The master tape mentioned under (a) can now be used for completion of the sales invoice, the only additional information required being the quantity and value.
- (d) Through the medium of a tape-to-card converting machine punched cards can be produced for use in the tabulating of accounts receivable and sales statistical information.

The above illustration refers basically to data processing as it affects the income phases of the business. Another practical application is the purchasing, payment, cost distribution function. In either case, the data introduced into the system at the commencement of a transaction is

automatically perpetuated throughout the business cycle. This is integrated data processing.

This brief description of the mechanical aspects of an integrated data processing system, however, merely scratches the surface of its implications to modern industry. It has been said that "automation" is ushering in the second industrial revolution, but automation in the factory cannot go forward without automation in the office and it is this function that a modern integrated data processing system must perform.

Integration Not New

In order to develop this theme further we should probably now discard the term integrated data processing in favour of electronic data processing, for this is a logical extension of the common language system. This is not intended to minimize the value or importance of an IDP system, however. Integration, *per se*, is by no means new as far as data processing is concerned. A little sober reflection will reveal that even the simplest accounting system has elements of integration in it that makes it partial "integrated data processing". What is currently called IDP then is merely a further extension of an existing trend accelerated by the use of mechanical equipment.

What we have done so far is to show how all, or substantially all, subsidiary documents directly in the line of progression of the particular field concerned can be generated from a single typing of an original document. An IDP system properly applied to sales can from one writing produce most, if not all, documents required for sales control. It cannot, however, without additional equip-

ment perform any analysis. Further, it must be recognized that in any mechanical system accuracy of an original document is essential to the accuracy of the system. An error level which is tolerable in a manual system (because it is audited, processed and reviewed by many different people who usually catch most of the errors) will be fatal in an IDP system. Audit controls and routine internal controls must be established right at the point of data origination. From then on rather simple controls such as cross-foot totals, overall control balancing totals, etc. can serve to detect errors in the system.

As already mentioned, IDP aims at integration in a specific area, i.e., sales, disbursements, accounts receivable or some such field. This is a real step forward, but how much better it would be if the whole system could be integrated. It can — by the use of an electronic computer, and with this tool in the system it is called “electronic data processing” — EDP.

IDP Related to EDP

It should be pointed out at the outset that IDP and EDP go hand in hand. A computer is a tremendously flexible tool which will perform a fantastic amount of work in a very short time. If its potentialities are to be realized, however, it must be provided with input data in an efficient manner. This requires some sort of IDP system in processing input data. Fortunately the computer itself can do most of this processing and it is therefore not essential to install IDP systems before proceeding to the use of a computer. In cases where the computer is being heavily loaded, or where the volume of data is large, separate IDP systems to sort, process,

and handle input data are probably desirable and usually more economical. It is not, however, essential that you mechanize your operation before installing a computer. If you are not now mechanized, you can proceed directly to a computer providing that you are prepared to do a really down-to-earth, thorough-going methods job. This is no hardship, for if you install a computer you will have to do this basic study in any event.

Why is this so? An electronic computer is a management tool of infinite potential. It differs from an IDP system in that in addition to processing data it will also:

- Add
- Subtract
- Multiply
- Divide
- Compare
- Make logical decisions.

But you must tell it — in detail — what to do — this is called “programming”. In order to do this you must know every detail of your operation and, most important, you must clearly define your problem. For this reason a methods job is necessary. Happily once the methods study is completed the coding of the operation is not too difficult a step. Even more happily this type of methods study has proven, in every documented case so far, to be of great value in increased efficiency.

Toward a Scientific Management

In considering the adoption of IDP or EDP techniques in a business operation many executives look first for a dollar saving. This is the major criterion used to determine whether or not they should enter the field, and there is no doubt that many people base their decision on this one

factor. While there is also no doubt that savings are probable, the major advantages are in other areas. Here is a tool whose full potential has not yet been determined. Here is a tool which makes scientific management possible, which provides extreme speed and versatility. It can provide greatly improved and simplified information for management, do complex scientific calculations with great speed and accuracy, and many other things. If you can measure the extra profits through improved management, justification on the basis of increased profits will be possible. But if EDP is not considered because immediate clerical savings cannot be realized, then only the least important advantage has been reviewed.

Unlimited Potential

The use of a properly designed EDP system with an electronic computer at its core makes management by exception possible. For instance in any inventory control job, once a methods study has set inventory standards, it is no longer necessary, each month, to wait two weeks for an inventory report listing each item in detail. Now it is possible, daily if necessary, to list only those items where action is required; and this can be done in a matter of hours rather than weeks. This type of approach can, with suitable modification, be applied to every area of accounting and control. If one lets his imagination soar, without the bias imposed by the limitations of present manual or semi-mechanical systems, it is not difficult to see that the potential of

EDP is indeed unlimited. Here are just a few possible applications:

1. Payroll—from basic time information payroll cheques, cost distributions, etc. can be produced automatically.
2. Sales — From an original sales order we can automatically get:
 - (a) delivery order,
 - (b) invoice — priced and extended and tax calculated,
 - (c) sales distribution,
 - (d) trade and market analysis,
 - (e) accounts receivable,
 - (f) ledger posting.
3. Inventory control.
4. Production control — including optimum machine scheduling.
5. Quality control.
6. Factory cost-analysis and distribution.
7. Scientific and design calculations.
8. Operations research.

These are but a few applications out of many. There are undoubtedly many more. When every accounting application is mechanized it is but a short step — a further integration — to produce financial statements automatically.

Thus the scope of mechanization of records and similar data is almost limitless because of the development and introduction of a great variety of data recording and processing machines. Whether complex or simple, however, probably the best definition of "integrated data processing" is the orderly automatic recurring use of original data throughout the complete business cycle.

Taxation of Canadian Oil and Gas Companies

D. A. MCGREGOR

GENERALLY SPEAKING, the income for tax purposes of corporations operating oil and gas wells is determined in the same manner as the income of any other business. However, special deductions are allowed to those taxpayers in respect of:

1. Drilling and exploration expenses, including all geological and geophysical expenses.
2. Depletion allowances from income derived from the operations of an oil or gas well.

Deductions for Drilling and Exploration Expenses

Legislation providing specifically for deductions of drilling and exploration expenses was first introduced during the war to encourage exploration for oil and gas and the drilling of new wells. The original legislation referred to:

1. All exploration costs and the drilling costs of wells spudded in and abandoned within six months of drilling by corporations whose principal business was production, refining or marketing of petroleum products.
2. All exploration and drilling expenses incurred by corporations, associations, syndicate or exploration

partnerships formed for the purpose of exploring and drilling for oil or for natural gas.

From 1943 to 1947 qualifying taxpayers were allowed a percentage of their expenditures as a deduction from taxes payable and for 1948 and 1949 were allowed 100% of the qualifying expenditures as a deduction from income.

Although corporations whose principal business was production, refining or marketing of petroleum products were not allowed a deduction for the drilling costs of productive wells under the above legislation, they were permitted to recover these costs by means of additional allowances for depletion.

The Income Tax Act introduced in 1949 did not contain provisions in respect of drilling and exploration expenditures, but the 1949 Amending Act did contain similar legislation. This legislation provided special deductions for the years 1949 to 1952 and the annual amending Acts subsequently extended the period to 1957. In 1953 similar provisions relating to mining corporations were combined with those relating to oil and gas corporations to permit eligible corporations in the mining indus-

try to deduct costs of drilling and exploring for oil and gas and vice versa. In 1955 the deductions for drilling and exploration expenses were made a permanent part of the Income Tax Act (section 83A).

Gist of the Legislation

The legislation referring to deduction of drilling and exploration costs by corporations as it now stands is condensed below (a summary of this legislation follows later in the article):

A corporation whose principal business is

- (a) production, refining or marketing of petroleum, petroleum products or natural gas, or
- (b) exploring or drilling for petroleum or natural gas, or

(c) mining or exploring for minerals, may deduct in computing its income for a taxation year, the lesser of

1. the total of
 - (i) drilling and exploration expenses, including all general geological and geophysical expenses incurred by it on or in respect of exploring or drilling for petroleum or natural gas in Canada, and
 - (ii) the prospecting, exploration and development expenses incurred by it in searching for minerals in Canada after the calendar year 1953, and
 - (iii) drilling and exploration expenses incurred in exploring or drilling for petroleum or natural gas in Canada or prospecting, exploration and development expenses incurred in searching for minerals in Canada, which sums were expended after the calendar year 1953 pursuant to an

agreement under which it undertook to incur those expenses in consideration for

- (a) shares of the capital stock of a corporation that owned or controlled the mineral rights, or
- (b) an option to purchase shares of capital stock of a corporation that owned or controlled the mineral rights, or
- (c) a right to purchase shares of capital stock of a corporation that was to be formed for the purpose of acquiring or controlling the mineral rights

to the extent the above expenses were not deductible in computing income for a previous taxation year, or

2. of the total of the above expenses, an amount equal to the income of the corporation for the taxation year,
 - (i) if no deduction were allowed for depletion, and
 - (ii) if no deduction were allowed for drilling and exploration expenses,
 minus any deduction allowed for the year for dividends received from other Canadian companies.

There is somewhat similar legislation in effect for associations, partnerships and syndicates which is to the effect that:

An association, partnership or syndicate formed for the purpose of exploring or drilling for petroleum or natural gas may deduct in computing its income for a taxation year, the lesser of

1. the total of drilling and exploration expenses, including general geological and geophysical expenses incurred by it on or in respect of exploring or drilling for petroleum or natural gas in Canada, or
2. of the total drilling or exploration costs, an amount equal to the income of the association, partnership or syndicate for the taxation year, if no deduction were allowed for drilling or exploration costs.

Commencing in 1954 deductions were allowed by regulation to individuals in receipt of income from oil or gas wells in Canada permitting them to deduct from the income of each such well an amount equal to the cost of drilling the well. This deduction does not include exploration or geological and geophysical costs and is limited in each year to the income of the well itself.

A similar deduction was allowed at the same time to taxpayers in receipt of income from oil or gas wells outside of Canada. Taxpayers by definition include corporations, individuals, associations, partnerships and syndicates.

The Present Position in Brief

Therefore, to summarize the present position in respect to the deduction of drilling and exploration expenses it may be said that:

1. Qualifying corporations, that is, corporations whose principal business is —
 - (a) production, refining or marketing of petroleum, petroleum products or natural gas, or
 - (b) exploring or drilling for petroleum or natural gas, or
- (c) mining or exploring for minerals
may deduct in computing their income all their drilling and exploration costs incurred in Canada, but only the drilling costs of wells outside of Canada from which they are receiving income.
2. Other corporations may deduct the costs of drilling a well from the income of a well that is outside Canada but may not deduct general exploration costs and of course cannot claim the costs of a dry hole since there would be no income to deduct costs from.
3. Syndicates, associations and partnerships formed for the purpose of exploring or drilling for petroleum or natural gas receive allowances similar to those extended to qualifying corporations.
4. Individuals may deduct the costs of drilling a well only from the income from that well whether it is located inside or outside of Canada but may not deduct general exploration costs or the costs of dry holes.

The amount of drilling and exploration expenses that qualifying corporations are entitled to deduct from income is restricted to the lesser of

- (a) the expenditures incurred to the end of the taxation year, to the extent they were not deductible in previous taxation years, or
- (b) income for the year, as defined.

Allowable expenditures in excess of income for the year may be carried forward from year to year until income as defined equals or exceeds expenditures.

Meanings of Terms

Income for purposes of determining the amount deductible is defined

as the income for the year before claiming any allowance for depletion but after deducting non-taxable dividends received. Thus a corporation may not claim an allowance for depletion until all its drilling and exploration expenses have been applied against income but it is not required to apply such expenses against non-taxable income. In effect, any allowance for charitable donations or business losses is denied until income exceeds drilling and exploration expenses.

The Act does not contain a definition of "drilling and exploration expenses" but in practice the term is broadly interpreted in the case of those companies which are engaged solely in carrying on an active exploration and development program, to cover all expenditures in Canada, including general and administrative overhead, with the exception of

- (a) lease rentals in excess of \$1 per acre per year,
- (b) bonus costs of lands except in certain specific instances referred to later,
- (c) cost of depreciable capital assets,
- (d) expenditures which are not permitted as deductions from income by the general provisions of the Income Tax Act such as payments for goodwill, etc.

Drilling costs include not only the actual costs of drilling, but also the costs of building access roads and the preparation of the drilling site, costs of casing, cementing and bringing the well into production. Tubing, pumps, flow lines, tanks and other equipment above ground are considered to be capital assets subject to capital costs allowances. The term "lease rentals" also includes reservation rentals and permit fees, etc.

In order for a bonus payment to qualify as a drilling and exploration expense, all of the following conditions must be met:

- 1. The bonus must have been paid in 1953 or a subsequent year to the Government of Canada or a Province;
- 2. The bonus must have been paid for a lease as distinct from a reservation, permit or licence;
- 3. The lease must have been surrendered without receiving any consideration or without having obtained any production therefrom.

Companies may jointly acquire a lease for a bonus consideration and deduct their respective share of the cost if the conditions outlined in the above provisions are met. However, if one company acquires a lease for a bonus consideration and subsequently sells a part interest in the lease to another company, no deduction will be allowed if the lease is surrendered on the grounds that a consideration has been received for it.

The sections of the Act pertaining to the special deductions allowed to corporations for drilling and exploration expenses refer to the expenses "incurred" by the company. Accordingly, in order to qualify, drilling and exploration expenses must be incurred by the corporation or incurred on its behalf by an agent under an agreement whereby the taxpayer has agreed, before the expenditures are actually made, to reimburse the agent for expenditures made on his behalf. Where a company acquires an interest in a property under an agreement which provides for the reimbursement of drilling or exploration expenditures previously incurred by the vendor, the amount so paid will

be regarded as a cost of acquiring property and not as a deductible drilling and exploration expense.

An Illustration

For example, let us assume that companies A, B and C enter into an agreement to develop a reservation which they have acquired jointly. One of the companies, say Company A, is appointed operator and Companies B and C reimburse Company A monthly for the expenditures it has made. Each of the companies would record their share of the costs on their books and each of them would be allowed its proportionate share of the expenses. If, however, we assume that Company A agrees with Company B to drill a well at A's sole expense on B's land for a 50% interest in the land, Company A, having paid all the expenses of the well, would be deemed to have incurred all the costs and therefore entitled to the development deduction. Company B, on the other hand, would not be deemed to have incurred any of the costs.

Since the deductibility of exploration expenditures is restricted to the corporation which incurred the expenditures, a corporate reorganization which involves a new corporation being formed to carry on the business of one or more predecessors will result in the loss of any unused expenditures of the predecessors. Similarly, where the assets of one corporation are acquired by another corporation, any unused expenditures of the acquired corporation would not be available to the acquiring corporation. This potential loss of tax advantage has been a very real deterrent to otherwise desirable corporate reorganizations in the industry.

Contract drilling companies are

considered to fall within the meaning of "a corporation whose principal business is production, refining, marketing of petroleum, petroleum products or natural gas or exploring or drilling for petroleum or natural gas" in those instances where the company is engaged in drilling for its own account and risk and accordingly may deduct its costs incurred in drilling oil or gas wells or exploring for minerals in Canada from its income. This situation would also be applicable to drilling partnerships.

Depletion

Under the old Income War Tax Act there was generally allowed a depletion rate of 33-1/3% to taxpayers operating oil wells and 25% to those operating gas wells or holding gross royalty interests. When the Income Tax Act was introduced in 1949 the regulations issued under that Act provided for two rates of depletion, namely —

33-1/3% of net income to operators,
25% of gross income to non-operators.

No distinction was made between oil and gas income. The regulations did not define the term "operator" until 1954 when an operator was defined as one "who had an interest in the proceeds of production from an oil or gas well or a mine, under an agreement which provides that he shall share in the profits remaining after deducting the costs of operating the well or mine". Therefore taxpayers who have a direct interest in a well or who have income from carried interests or net royalty interests are considered to be operators and entitled to a 33-1/3% rate whereas taxpayers who have gross royalty interests are considered to be non-operators and entitled to a depletion rate of 25%

The present regulations to the Income Tax Act read as follows in regards to operators —

"Where the taxpayer operates

- (a) an oil or gas well,
- (b) a precious metal mine,
- (c) a base metal mine,
- (d) an industrial mineral mine in respect of which the Minister of Mines and Technical Surveys has certified that the mineral is contained in a non-bedded deposit or that the mineral is sylvite, or
- (e) more than one of such wells or mines,

the deduction allowed is 33-1/3% of the aggregate of the profits minus the aggregate of the losses of the taxpayer for the taxation year, reasonably attributable to the production of oil, gas, prime metal and industrial mineral from such wells and mines.

"In computing the profits reasonably attributable to the production of oil, gas, prime metal and industrial mineral for the purpose of this section, a deduction shall be made equal to the aggregate of the drilling, exploration and development expenses deducted in computing the taxpayer's income for the taxation year."

The Income Tax Department has always contended that an operator, in determining profits subject to depletion, must group the net profits and losses from all wells and deduct therefrom all drilling and exploration expenses claimed in arriving at taxable income, whether productive or non-productive. This interpretation has the effect of denying depletion in the case of operated wells until all drilling and exploration ex-

penses in all areas, whether productive or unproductive, have been deducted, thus postponing indefinitely a depletion allowance to those companies which are spending all or a large part of their income on drilling and exploration activities.

The industry feels that depletion should be calculated on the "well by well" basis, that is, on the profit from each individual well after deducting the drilling expenditures applicable to that well only. It has also been argued that the regulations in effect prior to 1951 actually permitted this basis and the recent decision by the Supreme Court of Canada in the *Home Oil* case has upheld this interpretation for the 1949 and 1950 taxation years. Although the Court's decision applied only to the years 1949 and 1950 it was felt that, notwithstanding a change in the regulations in 1951, it might be the basis of claiming "well by well" depletion in subsequent years. However, the Minister of Finance, in his March 1955 budget resolutions, indicated that the law and regulations will be amended retroactively to 1951 to ensure that depletion will be computed on the aggregate profits less losses of all wells after deducting all drilling and exploration expenses allowable in that year.

If the Federal Government implements this budget resolution it may eliminate the uncertainty in the interpretation of the law, but no doubt it will be a disappointment to the industry which was beginning to feel that at long last there was some hope of realizing "well by well" depletion.

Professional Ethics

DENIS GOODALE

IT SEEMS appropriate from time to time to re-examine some of the basic concepts of ethical standards upon which the conduct of the members of a profession is based.

Ethics in Relation to the Profession

To begin with it may be useful to refer to the generally accepted meaning of the term "profession" and the obligation which membership in a profession imposes. A profession is a calling in which one professes to have a special skill or knowledge or art and a desire to use it to serve others. This involves the use of judgment, and the possession of a special skill places on the possessor a great obligation to use this skill wisely. This ideal of public service is what distinguishes the profession from a trade or business in which the main object is to make a profit. Society bestows a privileged status upon a profession and as a result imposes stricter obligations upon its members than upon the general public. The professional society is obligated to see that its members accept this responsibility. In so doing it recognizes that technical education is insufficient for its students and that it must also develop a moral consciousness in them.

The leaders of the professional accounting societies which were formed in Scotland recognized from the start the importance of professional status among the members. A book published by the Scottish Institute, entitled "A History of the Chartered Accountants of Scotland", indicates that each of the Scottish Societies, in order to govern themselves and their members, adopted comprehensive rules and regulations. "It was recognized that members must be bound by a discipline or etiquette in all their professional dealings," and from this time all forms of advertising were frowned upon.

The importance of an accountant's conduct and the high degree of confidence which the public placed in chartered accountants were brought out in testimony by a witness in a legal case in the early 1900's. The witness stated that "Chartered accountants were regarded as above suspicion, like Caesar's wife, until something unfortunately was discovered against them."

Special Obligations

There is a special relationship existing between the member of a profession and one who has consulted him for advice, which imposes

certain obligations on the former. First there is the concept of public reliance upon the professional man which calls for trust in the profession and its members. There also exists the need for the professional man to keep the clients' secrets and confidences. This rule of conduct is fundamental. The professional member must place service ahead of personal gain.

In order that accountants could reach professional status it was necessary to adopt those standards of ethics which were recognized as being common to all professions. In this regard accounting was able to rely on the benefit and experience of law and medicine.

Rules of Professional Conduct

It has been said by an early writer "Ethics is a state of mind and if it is not innate it can never be acquired." Fundamentally ethics exists in the spirit in which a professional man approaches his work. Yet in order to obtain public confidence, it is necessary to have rules of professional conduct. The rules should be looked upon as guideposts and not as complete or exhaustive.

The introductions to the rules of professional conduct issued by the various Institutes of Chartered Accountants state that the rules are not to be taken as exhaustive and that they have been issued for the guidance of members. Disciplinary powers rest with the Council of each Provincial Institute. The usual power of the Council is to investigate "whether any member of the Institute has been guilty of professional misconduct or conduct unbecoming to a chartered accountant or of a violation of the rules or by-laws of the Institute".

The need for such rules is twofold — for the benefit of society and for the benefit of the profession itself — and most, if not all, professional accounting societies have them. However, since in most Provinces the practice of public accounting is not a closed shop and is not restricted to members of a professional society, the rules of the society apply only to its own members and not to others. This apparent inconsistency is not too serious. The profession by adopting and enforcing its rules has demonstrated that it intends to do what it thinks is right, and public confidence will be obtained as a result.

The question does arise as to whether the public interest would be better served if non-members were required to conform to a provincial law relating to desirable conduct. This could perhaps be obtained with a system of public licensing. It seems unlikely, owing to problems of enforcement, that the proposal would afford the public any more protection.

The rules of professional conduct of each Provincial Institute of Chartered Accountants are divided into five sections. It is proposed to deal only with those rules where areas of conflict sometimes arise. The reasons for the presence of specific rules will also be discussed.

The first section of the rules is entitled "As to Business or Employment". It deals basically with the duty of the member to the public. The second section concerns relations with fellow members. Others refer to restrictions on methods of procuring business and relations with clients, and there is a general section basically designed to preserve the association.

The rules are intended to apply to particular situations which may arise in accounting and which do not arise in other professions.

Points of Conflict

The rules of professional conduct govern the relations among members themselves and between the membership and the public. The following question may be asked about them: Does the application of the code involve a conflict of interest between members and the public? The point here is that every member of a professional organization has three loyalties, one to the client, one to the association and the other to the general public. Where a conflict of loyalties arises what should be the attitude of a member?

In an article in *The Journal of Accountancy*, November 1955, entitled "Ethics — The Profession on Trial" by Edward B. Wilcox, the author stated, "The challenge to the student of ethics is to find the answers to two questions: what is desirable behaviour, and why would anyone want to act that way." The first question he answered by indicating that "Desirable behaviour is that which produces the greatest good." In view of the complexities existing in our society it is often not easy to appraise the results of any proposed action in order to answer this question.

One rule of conduct which may give rise to conflict is that which requires a member to treat as confidential any information obtained by him as to the business affairs of his client. Suppose, for example, that the member becomes aware of an illegal act on the part of his client or an act which, although not proved to be illegal, is on the borderline and perhaps against generally accepted

morals. One example of this sort may be in the area of taxation, where the client may be attempting to evade taxes on income. What is the duty of the accountant under these circumstances? Since he commands the confidence of both his client and the government, he must insure that the client obtains the full benefit of every provision under the taxation statute and should also determine that there is no evasion of income tax. There may be a wide difference of opinion here. It would seem, however, that the accountant's primary duty is to the law.

A further conflict may occur where a member is compelled to produce his working papers in court or is required to testify against another member in court. The need for maintaining secrecy of a client's affairs is something which is inculcated in the accountant early in his training period. However, the public interest is generally regarded as being more important than the accountant's duty to his client and for this reason the accountant's knowledge of his client's affairs is usually not privileged by law.

There is also the possibility that a conflict of loyalties could arise between the obligation of a member to his association and his obligation to the public. The rules of professional conduct state that "no member shall take part in any effort to secure the enactment, alteration or amendment of any Provincial or Dominion statute affecting the profession without giving immediate notice thereof to Council". Let us assume that it is proposed to alter the entrance requirements into the profession in order to meet the increased demand for professional accounting services.

Suppose that a member was convinced that such an amendment would clearly react to the benefit of everyone except perhaps the accountants. Should the member support the proposed legislation or not?

Another rule in the code could conceivably give rise to a conflict of interest between the profession and the public. This rule prevents a member from becoming associated with any association of accountants or auditors unless the society has been approved by the Council of the Institute. In addition, it purports to prevent members from becoming associated with a college or school or university "which conducts its operations, solicits prospective students or advertises its courses by methods which in the opinion of the Council are discreditable to the profession". It may be possible that situations or activities could arise which might be beneficial to the public, for example, advancement and extension of education and opportunities in the field of education, which a member could not support because of the foregoing rule.

These few examples have been noted in order to emphasize that a conflict of interests could exist between the professional association and the public or between the duty of a member of the profession to his client and his duty to the public. It is generally thought that the duty to the public is paramount and the Institute and its members would yield to what they considered were the interests of the public.

Problems Arising

There will probably always be questions from time to time with respect to the interpretation of the rules of professional conduct as applied to specific situations. One may

also ask whether the code takes the proper attitude towards certain problems and whether or not it should be amended to take into account current changes in thinking.

One such problem is the association of members of a firm of chartered accountants with management consulting firms. Services "which are not foreign to the functions of a chartered accountant" may be offered to the public by the same member representing both firms. Although a "corporation is held to be incapable of exercising professional functions," the management consulting firms are incorporated.

There is the question of the extent to which a Provincial Institute should engage in institutional advertising on behalf of the practising members within the Province.

Another question to which the code of ethics does not provide an answer is to what extent a practising member is responsible for the education and training of the students employed in the firm.

Although a member is required to enquire into the circumstances under which the services of another member of the Institute have been discontinued, should the Institutes make it compulsory on the part of an incoming auditor to contact the predecessor in order to ascertain the reason for the change? It seems that not all of the Institutes have this requirement. This courtesy would help to preserve professional standards by preventing clients from threatening to change auditors. It might also provide a member with the reasons why the engagement should not be accepted.

One rule which will likely be difficult to enforce is that designed

to prevent a member from acquiring "a beneficial interest in any business, profession or occupation in the conduct of which he utilizes his confidential knowledge of a client's affairs".

Reference will have to be made to the views of society as to what are the accepted beliefs of the time in attempting to interpret new situations. Standards of business conduct have been developed down through time by human conduct and not by moral philosophers. People are expected to behave in a manner beneficial to society as a whole and to refrain from harmful actions.

Survey of the Institutes

In order to ascertain the nature of actual ethical problems with which accountants may be faced today, letters were written to each of the Provincial Institutes of Chartered Accountants requesting information dealing with matters involving professional ethics which had come to the attention of their Council. Replies were received from all but one Institute. Three provided an outline of the cases which had come before their Council in the last 15 years. Three replied that they could provide no information owing to the amount of work involved in compiling the data and also they felt, as one reply stated, that the information could not be released "even on an anonymous basis".

Three of the smaller Institutes (two of which are widely separated geographically) provided almost identical replies. The first one indicated that there had been no ethical problems of any consequence during the last 15 years. One of the other correspondents stated that the

last cases dealt with occurred a little over 20 years ago. The third indicated that there had been no formal complaints "in the memory of any members of the Council".

The spirit in which the rules of conduct have been followed in this Province is illustrated by a quotation from the reply received: "Although occasionally one hears a complaint, it is usually a petty matter and apparently is settled quietly. In the instances which have come to my attention it has almost always been a lack of knowledge of the principles or over-enthusiasm on the part of young practitioners. Certainly such breaches have not been serious enough to justify any formal complaint against the member."

Actual Cases

The following will deal in summary form with the outline of cases arising in the three Institutes which did provide information. In each of these the number of cases dealt with was exceedingly few during the 15 year period. The situations which arose concerned mainly the following rules of conduct:

- (a) The acceptance of business without enquiry into the reasons under which the services of another member had been discontinued.
- (b) Soliciting business entrusted to another member of the profession.
- (c) Soliciting business by advertising other than by publication of a professional card.
- (d) One instance in each of two Provinces of a member of another Institute using the designation "Chartered Accountant" although not being a member of

the Institute in the Province in which he was working.

- (e) The issuance knowingly of a statement or report containing a false or misleading statement.
- (f) Articling of a student by a member where the employee remained on the staff of a client.
- (g) One instance was cited of a member operating a branch office without it being under the management of a member of the Institute.
- (h) The question arose in one Province as to whether the name of an American firm of accountants could be incorporated with that of a firm of chartered accountants. The Council ruled that no firm could practise as chartered accountants unless all of the partners were chartered accountants and members of the Institute or some registered society.

One reply indicated that a number of instances of a member soliciting business entrusted to another member had come to Council's attention, but no formal complaint had been laid.

It seems that the following conclusions may be drawn from the information contained in the replies received:

1. The majority of the few complaints arose mainly in connection with advertising or soliciting.
2. There are more violations than those formally registered with each Provincial Council but these are of a minor nature. The more serious cases are likely to be revealed.
3. The profession on the whole, has been worthy of public confidence.

The Accountant's Independence

By way of conclusion, it may be appropriate to refer to a most important ethical concept, one upon which the continued confidence of the public largely depends, namely the concept of independence. Independence or objectivity is an attitude of mind and its application to auditing is perhaps best expressed by the statement in the preface to Montgomery's *Auditing* (7th ed.). The primary purpose of auditing, according to that standard text, is "the discovery and disclosure of truth".

The requirements of the Companies Acts with respect to persons not qualified for appointment as auditor of a public company are an attempt to secure independence. The auditor of a public company cannot be a director or officer of the company or a partner or in the employment of a director or officer of the company.

Other rules of professional conduct which are designed to preserve independence are those preventing the payment of commission for work received and prohibiting a member from bargaining to receive a fee (other than from his client) without the knowledge and consent of the client. The rule aimed at eliminating competitive bidding for professional engagements is yet another.

Society bestows upon a profession a privileged status and in doing so places a high degree of confidence and trust upon its members. If the profession is to prove that the trust is justified it must regulate the conduct of its members in a manner that will coincide with the public interest. Most important, it must always keep in mind that its strength and stature is founded on its independence.

Grain Accounting for Western Canada

WALTER J. MACDONALD

THERE ARE two prerequisites to an understanding of accounting for grain grown in Western Canada. One is a knowledge of the methods involved in the physical handling and marketing of the grain. The other is an appreciation of the control which certain regulatory bodies exercise over those methods.

Since the early years of this century, the Canada Grain Act has governed the physical handling of grain through the Board of Grain Commissioners, in two distinct geographical divisions. Under the terms of the Act the Western Division, with which this article is concerned, extends from the Lakehead at Port Arthur on Lake Superior and Churchill on Hudson's Bay westward to the Pacific Coast and includes the terminal grain elevators at both boundaries. The Eastern Division covers all the area east of Port Arthur. The Western Division produces grain primarily for "export", meaning export either to a foreign country or to Eastern Canada, while the Eastern Division produces mainly for domestic consumption within the Division.

The grain-handling facilities of the Western Division take the grain from

the hands of the farmer and channel it through a network of country elevators — some 5,500 in all — to the terminal elevators at Lakehead and Churchill on the east and at Vancouver and Prince Rupert on the west. Some grain is drawn off from this "export" stream temporarily for storage at interior terminals or to meet the requirements of mills and maltsters within the Division. However, in general it is valid to conceive of the Western Division as a huge gathering net which feeds Western grain to its world markets. In the gathering process the physical properties involved are the country elevator, the railroad car, the interior terminal elevator, together with terminal elevators on the perimeter of the Division.

At every stage grain is handled predominantly in bulk; sacking is rare.

Handling of Western Grain in the Western Division

When, in the first instance, the farmer loads his raw grain from his field or granary on to his truck or wagon, certain alternatives are open to him. He may place it in storage temporarily at the country elevator, he may sell it outright then or later

at the country elevator, or he may ship it direct to the terminal for his own account.

THE COUNTRY ELEVATOR

Situated on railway trackage at convenient points there are country elevators, generally of frame construction. Here the farmer can unload his grain, have it weighed, sampled (to determine grade and dockage content), cleaned, if cleaning is required and if cleaning facilities are available. (In any event cleaning at a country elevator is generally a primary treatment; secondary or final cleaning occurs at terminal.) The grain is then elevated into bins for storage. The elevator will keep it in condition and at a later date, again by elevation, deliver it into rail cars for shipment or to trucks for local use.

A modern elevator is equipped with automatic dump equipment to facilitate unloading from the farmer's wagon or truck.

Alternatively, the farmer may wish to load direct from his truck into the rail car. If so, he is entitled to the free use of the loading platforms provided under section 60 of the Canada Grain Act.

THE RAILROAD CAR

The grain is spouted from the country elevator or transferred by loader from the truck into railway cars for shipment. Its destination may be:

- (a) Terminal grain elevators at Lakehead, Churchill or Pacific Coast.
- (b) Interior terminal grain elevators at Saskatoon, Moose Jaw, Calgary, Edmonton and Lethbridge, or certain other interior terminals.
- (c) Mill elevators of flour mills, malting plants, seed and feed plants or other major processing or treatment units within the Division.
- (d) Occasionally direct to U.S. points or to terminal elevators in U.S.A., e.g. Duluth.
- (e) Eastern Canadian points for domestic use.

To ensure marketing quality, it is compulsory for eastbound grain cars to be held over in the railway yards at Winnipeg and westbound cars to be stopped at Calgary and Edmonton so that samples may be taken by the inspection staff of the Board of Grain Commissioners. Grade and dockage are thus determined before the cars arrive at the terminal elevators.

THE TERMINAL GRAIN ELEVATOR

A modern grain terminal elevator in the Western Division is in reality a highly technical processing plant. First, the grain in a multitude of grades is unloaded from the rail cars by means of power shovels or automatic car dumps. Under a government inspector and a government weighman it is sampled a second time, elevated and weighed. Unless it is already in first class condition it passes then to the workhouse bins convenient to the cleaners and dryers. In the workhouse it is processed by cleaning, and drying where necessary, and the dockage and any marketable foreign grain which may have inadvertently become mixed with it is removed. The grain then passes to the storage bins where it is warehoused with other grains of like grade awaiting shipment. When required for shipment, after a further inspection and weighing, it is discharged into rail cars or grain vessels as "export" grain.

In general, the terminal elevator treats grain in such a way that the finished product can be delivered to world markets in a minimum of acceptable and certified grades.

THE INTERIOR TERMINAL ELEVATOR

Grain within the Western Division may be delivered to interior terminal grain elevators located at Saskatoon, Moose Jaw, Calgary, Edmonton and Lethbridge, pending reshipment to perimeter terminals or to mills and maltsters within the Division. Operated by the government, these terminals are equipped with cleaning, drying and storage facilities somewhat similar to those at Lakehead and Coast terminals. Certain private-owned terminals are also operated in the interior of the Division.

The treatment at these terminals is more or less identical with that at perimeter terminals.

THE MILL ELEVATOR

Within the Western Division grain may be delivered to or through a "mill elevator" as defined in section 2(18) of the Canada Grain Act. These are elevators operated by:

- (a) Flour mills which require large quantities of wheat.
- (b) Malting companies which treat large amounts of barley.
- (c) Seed and feed plants and other such "manufacturing" units.

Mill elevators are equipped in greater or lesser degree to clean, dry and otherwise prepare raw grain from the field so that it is acceptable for milling or for other forms of manufacture, or for consumption.

Normally a government inspector and a government weighman are in attendance at mill elevators to certify grade, dockage and weight on all incoming and outgoing grain. ("Out-

going" includes that grain which goes from the "mill elevator" of a flour mill, malting plant or other manufacturing plant to the mill or other building where it is manufactured).

Handling of Western Grain Outside the Western Division

In all cases "export" grain is identifiable anywhere enroute to its final market as a shipment or part of a cargo of a certified grade ex terminal on a certain date. The name of the vessel or the number of the rail car must appear on the face of the certificate issued when the grain is loaded out from terminal.

All grain which leaves Lakehead or Coast terminal elevators receives a "certificate final", as it is called, issued by the Board of Grain Commissioners. This certificate establishes the grade of the shipment which it covers, regardless of the fact that the shipment may break bulk at the transfer terminals in Eastern Canada or at Buffalo and then be reshipped by rail or canal to the seaboard terminals at Montreal, Quebec, Saint John, Halifax, Portland, Boston or New York, there to be transferred to ocean-going steamships. Its identity must be maintained, and its quality is guaranteed by the certificate under which it left the Western Division.

For example, a shipment of 100,000 bushels of One Northern Wheat (trade designation "1°"), graded by certificate final at Port Arthur and loaded into a named lake freighter, will retain its identity (and cannot be mixed with other grades or other grains) when it is unloaded at Goderich, Ontario into the transfer terminal elevator for temporary storage, when it is loaded out to rail cars and transported to Halifax, and

when it is put through the seaboard terminal at Halifax to the ocean liner for shipment to England and delivery on the Liverpool market. The grade established when the grain left Port Arthur is the basis for delivery in Liverpool, and thus the Lakehead "certificate final" is one of the main documents supporting the sale. The same principle applies on all shipments ex Vancouver, Victoria, Prince Rupert and Churchill.

Regulatory Bodies

Since Prairie grain is grown principally for export, it is essential for the Canadian economy generally and the Prairie economy particularly that its handling be standardized and its grade guaranteed. With that end in view, a number of governing bodies have been set up to control the grain trade for the protection of the farmer, the trade, and the public.

These bodies are:

- (1) The Board of Grain Commissioners for Canada, with headquarters in Winnipeg, appointed to administer the Canada Grain Act.
- (2) The Canadian Wheat Board, a government-created sales agency to which at the present time the farmer must deliver his wheat, oats and barley for sale, unless it is for his own personal use. So that the grain-handling machinery will be available on an equitable basis to all farmers, this Board has power to fix the amount of any grain which the farmer *may* deliver to market from time to time.

The Board also regulates the flow of grain from country elevators to terminals and from terminals to sales position, in terms of actual or expected com-

mitments for delivery and sale.

- (3) The Winnipeg Grain Exchange, of some 400 members, organized primarily to regulate and operate the grain futures market.
- (4) The Winnipeg Grain and Produce Exchange Clearing Association Limited, (in trade phraseology "the Clearing House"), which furnishes the machinery for recording and clearing, on a daily closing price basis, the futures trading operations of the members of the Winnipeg Grain Exchange.
- (5) The Lake Shippers Clearance Association, which is in effect a bank for documents covering grain in the terminals at Fort William and Port Arthur or held aboard lake vessels for winter storage. This Association also supervises the loading of grain ex terminal to lake vessel or railway car.

The first two of these bodies are agents of the Government; the last three are creatures of the trade.

The Board of Grain Commissioners for Canada

Under section 9(1) of the Canada Grain Act, the Board of Grain Commissioners for Canada is the supreme authority in regulating the physical handling of grain in Canada. Its main functions in the Western Grain Inspection Division are:

(1) INSPECTION OF GRAIN

At the commencement of each crop year one of the Board's committees sets the standard for each grade of grain for that crop year. On that standard the staff of the Chief Grain Inspector is responsible to the Board for certifying the proper grade and dockage of all grain unloaded into or

out of grain terminal elevators, including "public", "semi-public" and "private" elevators, as well as "mill elevators" of all flour mills, maltsters, feed and seed plants, etc. within the Division.

(It is not practical or economical to provide government inspection or weighing service at country elevators or at smaller mills, seed or feed plants.)

Although, as already stated, advance samples are taken at certain stop-over points enroute to terminal or mill, samples are again taken when grain is unloaded at these destinations. A certificate showing final grade and dockage content is issued for each car examined and a daily report sheet lists all the cars inspected into each point. Copies of these documents are sent to the Statistical Department and the Registration Department of the Board.

In the eyes of the Board the mill elevator of a flour mill is in the same position as a terminal elevator at the Lakehead or Coast. Therefore grain transferred from the mill elevator to the mill proper must be inspected just as if it were shipped for "export". The Board's jurisdiction only ceases when the grain is taken for "manufacture" from the "mill elevator" to the mill proper.

(2) WEIGHING OF GRAIN

Under the regulations of the Board of Grain Commissioners the Chief Weighmaster and his staff are responsible for certifying the weight of all grain unloaded from or to wagons, cars or vessels, at a terminal elevator, private elevator or mill elevator in the Division. Again, if outgoing grain is being transferred from the mill elevator of a flour mill to the mill proper, it must be weighed out

under government certificate. If grain is in damp condition in a terminal and has to be dried, it is weighed in to the drier by the weighman of the Board. Its weight outward is governed by the moisture content determined by the inspector in terms of inward weight and drying report.

The weighing authorities prepare daily reports of certified weights at each point where a weighman is located. These reports correspond to those for grades established by the inspector and reach the same authorities.

* * * *

The combined governmental inspection, grading and weighing establish a firm foundation for the grain trade from start to finish. The farmer, unless he chooses to accept the weight and/or grade offered by the country elevator, can receive government grade through having a sample taken on delivery at the elevator on a "subject to grade" basis. On carlot shipments he receives government grade and weight direct. Correspondingly, the buyer receives a government certificate of grade on all grain exported from the Division. Basically, trade within the Division is supported by government grades and weights.

In addition, by tabulating the daily reports of its staff and supervising the weigh-over of the terminals and mill elevators at the end of the grain year, the Board itself has an authentic record of all the grain weighed in and out of each major handling unit in the Western Division during each crop year. Adjusted in terms of year end stocks, this record shows the overages or shortages in each grade. Subsequent certification by the inspector and the weighman at the terminal establishes the net overage and

authorizes the registration of warehouse receipts in the required weight and grade of grain.

The Registrar is an appointee of the Board of Grain Commissioners, and the warehouse receipt registered with him marks the culmination of the process which took the grain from the farmer's field and, if it was a contract grade, placed it in position for delivery against a futures contract.

In country elevators the Board's control is not as complete as at terminals, etc., but the Board does require a certified annual report from each licensed country elevator.

Excessive overages at these points, and at terminals, are dealt with by the Board.

The Canadian Wheat Board

The Board of Grain Commissioners exercises no jurisdiction whatsoever over the actual marketing of grain in Canada. During the years of the First World War the Canadian Government entrusted the marketing of wheat to a Board of Grain Supervisors for the 1917 and 1918 crops and to a Canadian Wheat Board for the 1919 crop. Again in 1935 the Government was obliged by the depression situation to pass an Act forming the present Canadian Wheat Board with authority to handle both wheat and coarse grains. The machinery of this Board continued into the period of the Second World War and is operative at the present time.

Acting through the grain companies as its agents, the Canadian Wheat Board takes delivery from the farmer, issues to him a producer's certificate and makes an "initial payment" to him. When at the end of the crop year it sells his grain, pooled

with other grain of like grade, it remits to him a "final payment" in the realized average price less its apportionable costs. If marketing operations should result in a loss, the government must bear the deficit. (There has not been a loss in wheat since 1940).

In all of its procedures the Board uses the established channels and agencies of the trade and it prescribes the forms and methods which its agent companies must adopt in reporting. Thus the country elevator company, acting as agent for the Board and for a fixed *handling* charge, accepts the grain from the farmer and pays him, under a contract to deliver his grain to the Board in terminal position. In turn it receives reimbursement from the Board on delivery of that grain at the terminal on the same basis as it paid to the farmer (Board price in store at terminal). It is reimbursed for the interest, insurance and storage in the interim by means of a *carrying* charge, computed on a bushel-day rate set by the Board. Having taken delivery at the terminal, the Board sells the grain as it sees fit in domestic and world markets, still using the recognized channels of the trade.

It has been established that once grain is delivered by the farmer as "Board" grain, it is the property of the Canadian Wheat Board.

Basically, the Board operates as trustee for the farmer in that it accounts to him for the net (pooled) proceeds of the grain which he delivered to it.

Apart from these controlled marketing methods, grain has been and is marketed in Canada using the machinery of the Winnipeg Grain Exchange which provides a price level

through its futures market. Wheat, however, was withdrawn from quotations on the Exchange in 1943 by government order, and is still in that position (1956).

The Pattern of Marketing of Western Grain

In the beginnings of the organized grain trade all grain moved eastward, and hence through Fort William terminals. Thus no matter what method of marketing was chosen, the basis throughout was "Fort William price". That factor in the pattern has remained constant. Grain delivered against futures contract on the Winnipeg Grain Exchange today *must* be in store at "Fort William" (including, for trade purposes, its twin City Port Arthur). True, grain now passes in volume through Pacific Coast terminals and Churchill, and cash grain is quoted by the trade and the Wheat Board "in store Vancouver" or "in store Churchill". But the preponderant movement is still eastward and the term "Fort William price" is still standard. It is synonymous with "spot" price.

In other ways the marketing pattern has changed materially in the last 35 years. Before the First World War "hedging" on the Winnipeg grain futures market was an integral part of that pattern. A line elevator company bought grain from the producer and, to cover its market position, sold futures of the month when it expected to deliver his grain at Fort William. A flour mill which contracted to deliver wheat flour at a given date covered its position by purchasing wheat futures to match the sale. If a producer himself wished to sell his grain for cash and thought the price would go up later, he could protect himself by

buying back the futures in like amount on a margin basis.

Governmental marketing of grain, such as occurred first in the case of the 1917 crop, broke that pattern. The Board of Grain Supervisors handled the 1917 and 1918 wheat crops on a flat price paid to the farmer, adjusted by grades.

The procedures of the 1919 Wheat Board were practically identical with that of the present Canadian Wheat Board. The 1919 Board, however, also controlled flour prices.

The marketing pattern was again broken in a different way with the advent of the farmer-operated "Pools" in the period 1923-1930. These Pools adopted the initial payment idea of the 1919 Wheat Board and likewise employed elevator companies as their agents, including later the elevators companies which were owned by the Pools themselves. However, they confined their operations to grain which was delivered by their members as "Pool" grain. Non-Pool farmers continued to use the open market, the Pools themselves were to an extent traders in futures, and both systems operated concurrently.

The present Canadian Wheat Board functioned in wheat with voluntary participation by the farmer on a floor price basis in some years, but with delivery to the Board mandatory since 1943. In certain years it has also functioned in the coarse grain fields. Delivery of oats and barley to the Board has been mandatory since 1949. Though the futures market does not operate in wheat, it still operates in oats and barley, government control notwithstanding. The open market system prevails entirely in flax and rye.

Because the Wheat Board uses the

elevator companies as its agents, Board grain (which the companies do not own) must be accounted for separately from non-Board grain (which they do own). The latter, under normal practice, is hedged on the futures market. The differing characteristics of government and free marketing pose different kinds of problems to the accountant. Each marketing method must be recognized and understood if grain operations are to be accounted for and audited efficiently and intelligently.

The Winnipeg Grain Exchange

The Canada Grain Act contains no regulatory provisions as to trading in grain futures contracts, but futures trading was and is a part of the grain business in terms of world trade. Hence we find an "Exchange" and a "Clearing House" which provide the technical machinery for an open market in grain futures. These two bodies are incorporated separately and are financially independent from each other, yet of necessity their operations are complementary. Both are located in the same building, and membership in both is customary for any grain firm of substantial size. Both have wide powers in their respective charters. Here it is proposed to deal only with those functions which are exercised under present-day conditions and which have some bearing on grain accounting.

The Winnipeg Grain Exchange is operated by its members, who are individuals. However, in many cases they are the employees of the major grain firms who are beneficial owners of the seats on the Exchange and on whose behalf the employee trades on the floor. The relationship of these firms is recognized by by-law 3(7) of the Exchange. The by-laws of the

Exchange also prescribe the method which is to be followed in creating and closing out a futures contract.¹

For example, a member who has bought the December future in an amount of 10,000 bushels and in trade terminology is "long" in that amount may expect to have that grain delivered to him during that month, on a date determined by the relative position of his trade with those of other buyers of that month's futures and by the volume of grain delivered by the sellers of the same futures. Under Exchange procedures the earliest trades receive the first deliveries on the contract for that month. Conversely, a member who has sold 10,000 bushels of the December future (in trade terms "short") and retains that "short" position into December must have that amount of that grain, in contract grade, to deliver against his futures sale before the end of December. Delivery under a grain futures contract means delivery of documents of ownership covering grain stored at Lakehead.

Any member's seat on the Exchange is in itself security available to any other member for debts incurred in the course of trade in Canadian grain. Thus, in the event of his bankruptcy a member's seat will be sold and the proceeds will be subject to a lien in the amount of any proven grain debt to any other member. This lien has priority over the claims of any other creditors. No seat can be transferred without notice to all members, posted on the trading floor.

The Exchange is not a direct party to futures trading. Its function is

¹ By-law 17 (the date of delivering *during* the month is at the seller's option).

that of a legislator and an arbitrator should any dispute arise between members.

The Clearing House

The formal title of this organization, which is the Winnipeg Grain and Produce Exchange Clearing Association Limited, is seldom heard in trade circles. The "Clearing House", as it is invariably called, provides a medium for clearing and recording futures trades negotiated in the pit by the members of the Exchange. It requires that its members, who may be corporations, shall be solvent. Financial statements must be provided for its files at least annually and otherwise at its discretion. Its officials naturally watch the position of any member who may be carrying open trades, long or short, in abnormally large volume. In some cases they may request protective deposits of cash.

To illustrate the operation of the Clearing House in grain futures contracts, let us assume that on the first day on which trading is permitted by the Exchange in May rye futures, member A buys from member B 100,000 bushels at \$1.00, and the closing price that day is \$1.01. Member A will report 100,000 bushels bought at \$1.00. Brought to closing price of \$1.01 he will show 100,000 bushels long at \$1.01 and will have earned a cash credit on that day of 1c per bushel or \$1,000 which he will request from the Clearing House. Member B will report 100,000 bushels sold short at \$1.00 and, brought to market closing price of \$1.01, he will be required to send his marked cheque for \$1,000 with his report. If, of course, the market reverses itself on the following day and closes at \$1.00, the open trades for each mem-

ber will be brought to the new closing price. To bring the open position to market on the second day A would pay \$1,000 to the Clearing House and B would receive \$1,000.

It should be said that this is only a part of an overall transaction. Member A who bought the May future was perhaps a processor requiring 100,000 bushels for May delivery. Member B was probably a line elevator company which had bought 100,000 bushels at country points expecting to deliver the grain in May at Lakehead terminal. In effect each had hedged his position: A by purchasing his grain at the price level at which he sold his malt; B by selling at the price level at which he had paid the farmer for his grain. When the grain is delivered in May by B to A the open positions of both will be closed out with the Clearing House, and A and B will have received or paid net \$100,000 (100,000 bushels at \$1.00) regardless of the interim variations in market levels.

Closing of a trade by delivery of the grain is not obligatory. The buyer of futures may sell them and conversely the seller may buy them. Any cash grain offsetting the transactions will be bought and sold concurrently at going cash prices. This procedure is obligatory when the grain hedged is below contract grade and hence not deliverable against the futures contracts.

The Clearing House may also operate as a bank in clearing inter-member debits and credits. It charges a fee for its services and renders monthly accounts to its members.

The underlying theory of the exchange and clearing process is to provide a market place where buyer and seller may meet and where prices for grain deliverable in store at Lake-

head, Pacific Coast or Churchill will adjust themselves in accordance with the law of supply and demand.

It must be stressed that futures contracts do not cover anything but "contract grades". Lower grades are subject to cash grain market fluctuations and cannot be hedged or protected directly through futures. For example, a country elevator operator buying "street" grain of non-contract grade at a discount below contract grade realizes that the price on delivery at the terminal may be better or worse than when he bought, and he governs himself accordingly. He can protect himself to some degree by selling the future when he buys the street grain and buying it back when he sells the cash grain.

A grain futures market similar to that in Winnipeg is active in Chicago.

Documentation of Grain Futures

The accounting procedures for documenting grain futures fall in a different category from accounting for other grain transactions. The initial record of the futures transaction in the pit is merely a memorandum of bushels and price on the pit cards of buyer and seller, good until closing time on the day of trade. At that time the transaction must be reported by both parties to the Clearing House. The seller will be "short"; the buyer will be "long". Each party to the trade must account daily to the Clearing House for the amount of the fluctuation from the price at which he bought or sold originally. He must also report daily, so long as the trade remains open, the amount of fluctuation from the closing price of the previous day. Settlements with the Clearing House are made in cash daily.

When the trade is closed out, the document used is called an "Account purchase and sale" or, in trade terminology, a "P and S". The "P and S" simply records the date of the original purchase or sale and the price, the date of the reverse transaction which closed out the trade and the price at which it was closed out. The difference is the apparent profit or loss to the customer of the pit broker who carried the trade. The "P and S" shows the commission on the deal, and the broker will see that his customer has protected him by way of margin during the life of the trade. For trades negotiated by a grain company on its own behalf a "P and S" is not required.

The Lake Shippers Clearance Association

This organization is mainly a depository for warehouse receipts covering grain held for storage in terminal elevators at Fort William and Port Arthur. It is also a supervisory agent in loading grain vessels. Documents covering ownership of grain and storage at these terminals are deposited with the Association by grade and weight. The credits for grain of like grade are thus established by the depositor, and covering grain in any one of the Lakehead elevators can be drawn on by him in large lots for shipment from one or two of these terminal elevators.

The value of this Association can be readily appreciated. Take, for instance, the case of an exporter who might have accumulated documents aggregating 100,000 bushels of 1° wheat located in ten different terminals but desirous of shipping the 100,000 bushels in one boat. Without the Association the freighter would probably have to up-anchor

and steam to ten different terminals to pick up its load of 100,000 bushels. If, on the other hand, the owner has deposited his grain documents with the Association the load may all be picked up at one terminal.

A Study in Costing

Basically, accounting for grain in Western Canada is a study in costing; costing of the stages in the flow of grain from farmer to the perimeter terminals of the Western Division and thence to market.

The first stage is the line or country elevator. Its accounts are those common to any primary processor of a raw product and in the accountant's view, its gross profit is essentially a merchandising profit. (Unlike an ordinary business, sales and purchases are not usually separated; only the gross profit in each grain emerges finally in the accounts). As a variant from the normal, the country elevator may act as a warehouseman pending actual acquisition of the grain for cash, or alternatively return of the grain to the order of the owner. Its charges are the first to come out of the farmer's grain.

The second stage is the rail car and the second cost is freight charge to the terminal.

The farmer may have shipped his grain direct to the terminal and so avoided the country grain elevator charges. Otherwise, both of these costs come out of the price which is paid to him basis in store "Fort William". The agent at the country elevator will calculate his price to the farmer after deducting his charges and the charges for freight to terminal and any other charges exigible against that grain after arrival at the terminal, except storage and elevation.

The third stage of costing is the terminal service. Primarily, the charges here are for warehousing, but a terminal may purchase the grain which it stores and, as the final processing agent, may clean, dry and mix grades, as the Act may permit. Thus its operations may include an element of merchandising.

The fourth stage (export) is in reality a series of costs. The terminal charges nothing to take grain into its plant because it recovers that cost through an elevation charge paid by the shipper when the grain is spouted from the bins to car or boat. Elevation is then one factor of export cost and storage at terminal may be another. Lake or rail freight to the East is another. Others are transshipment and storage charges at the transfer terminals on the eastern lakes, freight charges to seaboard, trans-shipment and storage at oceanport terminals and finally ocean freight to delivery point for foreign buyers.

Storage at terminal is an elusive factor. The elevation charge, always considered a cost of export, includes the privilege of free storage for a limited period of days. Thereafter storage will accrue against the owner of the grain, who may be a farmer, a trader in grain (including the Wheat Board in that category) or an exporter who is holding the grain in terminal pending sale or delivery against sale.

Of course all grain does not flow through all of these channels. Some is siphoned off to meet the needs of mills and maltsters in the West or goes directly to U.S. points without ever passing through the perimeter terminals. Some stops off at interior terminals to be stored temporarily enroute to the perimeter or to Western

mills and maltsters, and east-of-Lakehead grain may be taken from the main stream for mills and maltsters and for feed mills along the routes to the seaboard. The greatest flow, however, is to markets abroad through Atlantic or Pacific seaboard by the stages indicated above.

The principal documents are the cash ticket and storage ticket at the line elevator, the bill of lading when the car is in transit and the warehouse receipt at the terminal. The "unload" slip issued by the terminal for each car precedes the more formal warehouse receipt and shows the charges for freight, cleaning, etc. which are recoverable against the incoming shipment. The Lake Shippers Clearance Association "manifest" records the charges which have accrued on the grain (principally stor-

age and elevation) after its receipt in terminal and up to the point of delivery to the lake boat or railroad car for export. The chief document of export is the "certificate final".

Conclusion

In sum, the principles which govern accounting for grain are identical with those which govern other types of trading. However, the particular application of these principles to grain is marked by some notable differences. It is hoped that this article has assisted in a fuller understanding of the reasons for those differences. Grain is a prime factor in the economy of Canada and it behooves every accountant to have some conception of its accounting treatment.

A LAYMAN'S GLOSSARY OF ACCOUNTING TERMS



Last-in



First-out

A Review of the Sales Tax Report

H. O. SPINDLER AND D. R. HUGGETT

Last year the Minister of Finance appointed a 3-man committee to review and advise upon certain technical questions relating to sales and excise taxes, and their full report has just been published. The following review deals with its highlights and points up the formidable task which was undertaken. Thirty-one organizations made submissions to the members of the committee who were K. leM. Carter, F.C.A., Raymond Dupuis, Q.C. and A. E. McGilvray.

THE TAXES imposed by the Excise Tax Act account for about 26% of the total revenue of the Federal Government, while the sales tax alone accounts for about 14%. Being such a large source of revenue, only exceeded by the corporation and personal income taxes, it is surprising that in the past so little attention has been given to this form of taxation. Briefs are annually presented to the Minister of Finance outlining all the little inequities and imperfections of the Income Tax Act but nothing much is said about the Excise Tax Act. Of late, however, more attention has been paid to sales taxes, which attention has now culminated in the report of the Sales Tax Committee. This report covers most of the imper-

fections of the Excise Tax Act which have made the manufacturer's sales tax a frequent bone of contention.

The more important recommendations are that:

1. Selling price receive a more realistic statutory definition.
2. At some future date after suitable preparation and explanation to taxpayers, the basis of the tax be changed from the manufacturer's level to the level at which retailers purchase goods.
3. The Income Tax Appeal Board and the Tariff Board should be combined into a Tax Appeal Board to hear tariff, income and sales tax appeals.
4. A new definition of "machinery and apparatus" should be introduced, since the existing definition is unreasonably restrictive, and it should not be based on the opinion of the Minister.
5. All rulings, interpretations or intentions should be published immediately they are issued.

With respect to number 1 above, the Act, imposing as it does a sales tax at the wholesale level, completely ignores the fact that manufacturers sell to customers at different levels in

the marketing process; it merely provides that the sales tax be paid on "the amount charged as price". The committee reported that more taxable goods are probably sold to retailers direct from the manufacturer than pass through the wholesalers' hands and thus a strict interpretation of sales price would result in unequal taxes on like articles, depending upon the outlet used. As the tax is meant to apply at the wholesale price level only, the Customs & Excise Branch of the Department of National Revenue has evolved procedures to avoid this inequity. These procedures, developed over the years, consist of methods for the reduction of actual selling price to the wholesale level. For certain industries, the Department has fixed by regulation percentages which may be used to reduce the selling price charged to retailers and consumers to the wholesale price level. In other cases actual wholesale prices have been agreed to and confirmed by letter, and although these agreements are not published, only those with individuals are considered confidential.

The committee reported that it received relatively few complaints concerning the valuation methods employed by the Department although there was more widespread criticism of the lack of any right of appeal concerning such valuations. Since the Act does not appear to authorize the Minister to make such valuations, the taxpayer is obviously at a disadvantage until such time as the Minister has this authority and there are general rules for the determination of value. These shortcomings would seem to underlie the committee's recommendations that —

1. The existing scheme of valuation be continued for the present with statutory sanction.

2. Selling price receive a statutory definition.
3. Valuation agreements all be published in *The Canada Gazette* but values fixed by the Minister and not covered by agreement not be published.

The definition of "sales price" proposed by the committee seems to be a very apt piece of draftsmanship and is as follows:

- "1. The 'sale price' of goods which are sold by a manufacturer shall be:
 - (a) where the goods are sold to wholesalers — the amount for which those goods are sold;
 - (b) where the goods are sold to others —
 - (i) if the goods are of a class which the manufacturer himself sells to wholesalers, the amount for which the goods would be sold by the manufacturer if sold to wholesalers, provided that a substantial proportion of the total sales of the class are to wholesalers;
 - (ii) in other cases, an amount to be determined by agreement made between the Minister and the taxpayer or any group of taxpayers. In the event of failure to reach agreement the Minister may fix such sale price or prices as he may consider fair in the circumstances and these prices shall remain effective unless altered by the Income Tax Ap-

peal Board. The taxpayer shall have the right of appeal to the Board in respect of prices determined by the Minister which are not the subject of an agreement, and the Board shall fix such amounts without regard to the Minister's determination.

- "2. The 'sale price' of imported goods shall be the duty paid value thereof.
- "3. The 'sale price' of goods which are produced by a manufacturer and applied to his own use shall be:
- (a) if the goods are of a class which the manufacturer sells to wholesalers, the amount for which the goods would be sold by the manufacturer if sold to wholesalers, provided that a substantial proportion of the total sales of the class are to wholesalers; and
 - (b) in other cases, an amount determined as in paragraph (1)(b)(ii) above."

The committee reviewed the payment system under the "unlicensed wholesale branch" technique of accounting for sales tax. This technique requires a manufacturer using notional wholesale prices to pay the sales tax when goods are transferred to a warehouse which is not adjacent to his plant, or to a sales depot. The committee heard various complaints regarding this prepayment of tax but concluded that it was justified because such transactions (transfers to sales depots or warehouses) are essentially equivalent to the sale of the

goods to a wholesaler and it is at such time that the tax becomes payable. Accordingly, the committee recommended that "The 'unlicensed wholesale branch' technique receive statutory sanction, possibly in somewhat the same manner as is now contained in the Regulations."

The committee also examined the tax problem surrounding specially branded goods and concluded that usually the market value of such goods is comparable to that of other merchandise only at the retail level. Therefore, to apply sales tax fairly to these goods the committee recommended that "they be defined as a class and that a formula be devised to apply appropriate relative tax at the manufacturer's sales level". This definition would deem the merchants buying specially branded goods as the manufacturers thereof and the goods would be taxable on a notional sales price determined in accordance with the definition of "sales price" quoted above.

Other recommendations were made by the committee in respect of its first term of reference ("To examine the problem arising under sales and excise taxes where manufacturers sell to customers at different levels in the marketing process . . .") but, with the exception of the following, they are not of such widespread general interest. This recommendation (No. 11), the one that departs most radically from the present scheme and has been expected by those close to sales tax matters, reads as follows:

"At some future date after suitable preparation and explanation to taxpayers, the basis of the tax be changed from the manufacturers' level at which retailers purchase goods. This is the level used

for sales tax purposes in Australia. It follows that the broader base will produce increased revenues at the same rate. To obtain the same revenues the rates of sales and excise tax may be reduced equivalent to the average wholesaler's mark-up and this recommendation is made conditionally upon such a reduction.

"We recognize that this change would require substantial refunds in respect of tax-paid inventories of manufacturers and wholesalers."

This recommendation, if adopted, would certainly eliminate many existing administrative problems but whether this would be out-weighed by other problems consequent upon the widening of the tax base is difficult to predict, particularly as experience with this method has not been widely reported in this country.

The second term of reference of the committee required it "to examine the question of appeals from taxes imposed under the Excise Tax Act and make recommendations with regard thereto". The committee recommended that certain matters should be subject to appeal and that appropriate provisions be made for the implementation of appeal procedures. They also recommended that the Income Tax Appeal Board and the Tariff Board be combined to deal with all appeals from tariffs and income and sales taxes. It was suggested also that this new Board consist of businessmen and accountants as well as persons trained in the law.

In respect of its third term of reference, the committee saw evidence of imported merchandise bearing less sales and excise taxes than comparable goods of domestic manufacture.

This, of course, may occur when goods are imported in bulk and packaged in Canada or where packaged goods are purchased abroad at an earlier stage in the distribution process or where the prices of such goods omit some distribution costs. It was suggested that these problems could be eliminated by the extension of the definition of producer or manufacturer and more careful customs valuations.

The fourth and final term of reference required the committee "to examine the system of exemption . . .". The committee reported that in many instances the language used in the present list of exemptions is unsatisfactory and unduly restrictive. Guidance could be obtained, in their opinion, from the Sales Tax Act of Australia which, by the way, imposes the tax on the price paid by the retailer. The committee specifically singled out the definition of machinery and apparatus as being unduly restrictive and should not be based upon the opinion of the Minister. They then submitted a new definition of machinery and apparatus which seems to be much more reasonable than the present definition and which would exempt many items indispensable to production or manufacture which are presently taxed. This definition is as follows:

"Machinery, apparatus, equipment and structures and complete parts thereof which are to be used in or are indispensable for the production or manufacture of goods; and machinery, apparatus, equipment and structures installed in, or as part of, the building in which manufacture or production takes place, or on or near the site of production or manufacture of goods, for the safety, health or

comfort of the worker or as aids to production, or to be used in operations essential or accessory to the process of production or manufacture, or to create conditions essential for or favourable to production or manufacture; this exemption does not apply to:

- (a) machinery, apparatus, equipment and structures used in the transportation into, away from, or between distant sites of production or for the distribution or marketing of goods or for purposes of administrative overhead or sales promotion or operations accessory thereto; (b) for whatever purpose used, office equipment, furniture and supplies."

The Government appears to have taken cognizance of this part of the committee's report to the extent of a budget resolution to extend the machinery and apparatus exemption to:

1. Structures which are adjuncts to or provide access to exempted machinery;
2. Equipment used to repair and maintain such machinery;
3. Safety and accident prevention equipment;
4. Ventilation systems to remove noxious fumes or dust from plant premises;
5. Refuse or waste disposal machinery;
6. Hospital and first-aid equipment located in plants.

The committee also recommended that the present exemption of building materials be reviewed, enlarged and clarified. They intimated that the exemption of all materials used principally for building might be a good idea but were powerless to recommend it because it would entail a substantial loss of revenue.

It is hoped that these recommendations will be instrumental in producing a much more satisfactory Excise Tax Act.

Records Retention and Destruction

JOHN A. ORR

Every day almost all businesses produce records which they consider necessary to their operations but which will eventually lead them to a problem in filing, storage or possible destruction. Many businessmen say "We are creating, accumulating and saving too many records. Most of them are inadequately filed, and require too much space. We are becoming inundated with invoices, vouchers, internal memoranda, time clock cards, correspondence and books of entry."

Paperwork has become one of the costliest activities in business and a silent partner in our economy. Duplicating machines often aggravate the situation by producing copies at the turn of a switch and showering us with information.

Although many of us would like to think that we work with a clean desk top, the fact is that any executive's desk is cluttered with paper. Perhaps we should begin by switching the emphasis from the clean desk to the full wastepaper basket.

Paperwork is necessary, but it must not choke or become the master of other activities. Records should be kept to make available certain definite information which will be refer-

red to at one time or another, not just for the sake of keeping records. Information is best recorded in written form,

1. when there are waste motions resulting from mental or visual control;
2. when verbal or mental information is not sufficiently accurate;
3. when time for individual research is not available;
4. when lapses of memory become frequent.

A business cannot rely solely on mental control. It is expected that we are going to produce records and in so doing present ourselves with all the problems of an eventual accumulation which appears unavoidable. Since the storing of records costs money, the retention of all of them permanently would be uneconomical. At the same time the failure to keep some for a sufficient period could be embarrassing, to say the least.

We must then form a plan which will enable us to conquer the mountain of paper and to control, preserve and store our records. Such a plan will include adequate organized supervision and an inventory and classification of all records.

Delegation of Authority

Because nearly all company employees are able at one time or another to create records, management must take the lead in establishing control over them. Under its overall direction there must be some centralization of responsibility, as any program is bound to affect the procedures and working habits of all employees of the company. A company executive who is familiar with day-to-day operations and company policies should be made records retention manager and in order to facilitate his activities, his appointment should be made well known throughout the company.

The records retention manager will have to decide where to begin, what to do, how to do it and what results he can hope to achieve.

WHERE TO BEGIN

He should first require that all new records, as soon as they are originated, be classified as to length of retention. It is necessary to put this rule into effect immediately in order that all future records will be automatically taken care of.

WHAT TO DO

He must next devise a schedule indicating:

- (a) periods for records retention,
- (b) system for continuing control,
- (c) types of storage areas,
- (d) classifications of records which will indicate automatically their transfer to non-active storage or destruction.

How to Do It

He must determine if he himself is to work out his own record management programs or if he intends to consult with outside specialists in the

field. If outside assistance is sought, additional costs are involved depending on whether the outside consultant merely assists in the program or carries it through to the eventual issuance of a records control manual.

RESULTS TO EXPECT

Some of the results hoped for would be:

1. The reclamation of storage filing space through the reduction of records.
2. Accessibility of current records.
3. Release of active filing space for productive use.
4. Reduction of purchases of new filing equipment.
5. Storage of vital records in suitable filing areas.

Procedure Steps

A suggested plan for records retention and control will include:

1. An inventory of all company records.
2. A classification of records by
 - (a) retention period
 - (b) protection to be afforded.
3. Institution of forms control.
4. Devising transfer and destruction procedures.
5. Surveying storage facilities.
6. Ensuring continuing control by preparation of a records retention manual.

INVENTORY

A physical inventory must be made of all company records. This is a difficult assignment and the results must be carefully reviewed to point up the importance and value to the company of each record.

CLASSIFICATION OF RECORDS

A classification of all records by re-

tention periods must be made. The National Records Management Council, a non-profit professional organization specializing in consultation and installation of records management, has devised five standards for records retention and transfer. These are signified by the code word "V-A-L-V-E":

Value — operating and historical

Activity — rate of reference

Law — Federal and other statutes

Volume — cost versus value

Experience — comparable company practices.

Value

It is useful to code the records according to their value to the business. Different standards may be used; the American National Fire Protection Association has classified company records according to "after-fire" value as follows:

Class I

Vital records — Essential for the re-establishment of the business including those which may be used as a basis for loans or collections immediately after a fire.

Class II

Important records — Reproduction of which may be obtained but at considerable expense.

Class III

Useful records — Loss of which would be inconvenient but which might be readily replaced.

Class IV

Non-essential records — Material which has outlived its useful life.

Each of these classes will demand a different type of protection which will be discussed later. It is obvious that Class IV should be destroyed.

Activity

The rate of reference to records can only be determined after the installation of a planned program of continuing records control including

a requisitioning system for checking on all requests for old material. Employees may wish to retain records for long periods of time because they "refer to them so frequently". However, on tabulation over a period of several months a very accurate check could be made on frequency of reference.

Law

The present laws and regulations do not in most cases cover retention of records specifically, and there is a great divergence of opinion on retention periods. Two excuses frequently given for maintenance of files or records are that laws make it necessary or that past records will protect the company against lawsuits.

Without attempting a complete discourse on legal requirements, a few examples are of interest. Section 125 of the Income Tax Act, 1954, which refers to books and records, reads as follows:

125. (1) Every person carrying on business and every person who is required, by or pursuant to this Act, to pay or collect taxes or other amounts shall keep records and books of account (including an annual inventory kept in prescribed manner) at his place of business or residence in Canada or at such other place as may be designated by the Minister, in such form and containing such information as will enable the taxes payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined.

(2) Where a person has failed to keep adequate records and books of account for the purposes of this Act, the Minister may require him to keep such records and books of account as he may specify and that person shall thereafter keep records and books of account as so required.

(3) Every person required by this section to keep records and books of ac-

count shall, until written permission for their disposal is obtained from the Minister, retain every such record or book of account and every account or voucher necessary to verify the information in any such record or books of account.

Section 103 of the Canadian Companies Act outlines the requirements with regard to the maintenance of shareholder records, and section 111 reads as follows:

111. (1) Every company shall cause to be kept proper books of account with respect to

- (a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases by the company;
- (c) the assets and liabilities of the company;
- (d) all other transactions affecting the financial position of the company.

Government regulations concerning unemployment insurance, sales tax, etc. also have a bearing and their possible effect should be kept in mind.

Under section 28 of the General Conditions which were part of all munitions and supplies contracts during World War II, a contractor was obligated to preserve all his pertinent records until the expiration of five years from the date of termination of war.

So far no formal proclamation has been issued in regard to the termination of war, but in certain circumstances a committee set up for the purpose has permitted destruction of wartime records.

In brief the procedure involves:

1. The submission of a detailed list, an original and five copies of the records concerned, to the Cost Inspection and Audit Division of the

Treasury Department asking for their approval of the proposed destruction.

2. If they consider it in order, that department will refer the list to the Department of Defence Production for further processing through the committee.

Volume

Since there is a great variety in the quantities of the individual records with which we must deal, decisions must be made whether the cost of retaining high volume records is warranted by their value. In making these decisions the calculated risk of missing records will have to be taken into account.

Experience

It is helpful to refer to what other companies in similar lines of endeavour are doing. This information may be useful to the records retention manager in making decisions.

* * *

In applying the foregoing five standards it will become obvious that certain records, which must be kept permanently for historical and other purposes, become the memory of any organization. They contain invaluable background material explaining why and how decisions were made and provide a source of information for financing, advertising and public relations. They comprise a very small percentage of the total volume of records of any business. Studies of the National Records Management Council disclose that of the records presently maintained by average companies less than 10% must be kept permanently, less than 20% must be retained currently, 30% should be transferred to low cost storage, and 35% should be destroyed.

PROTECTION

Having established a list of certain records which we would retain permanently, we should then be able to apply the standards to the bulk of the volume and at the same time prescribe the protection necessary. Permanent records must have the ultimate in protection.

In order to decide on the protection required for the 50% which should be retained for varying periods, certain factors must be considered:

- (a) The extent to which their unavailability would delay recovery of moneys.
- (b) The extent to which their unavailability would delay restoration of production, sales and service.
- (c) The relative difficulty with which records could be replaced.
- (d) The difficulty or problems encountered if a record were not available for legal or other requirements.

Summarizing then, two sets of factors are necessary for the development of a records retention schedule:

(a) V-A-L-V-E

(b) Protection to be afforded.

With these two sets of factors in mind we should have a realistic approach to the inventory of records which must be undertaken.

CURRENT RECORDS

As mentioned earlier, one of the first steps is to classify current records at the point and time of creation. After completion of a records retention schedule based on the factors mentioned, we should immediately institute the classification policy on all current records.

FORMS CONTROL

While we established earlier that paperwork is necessary for the operations of any business, any good records retention program must concentrate on records "birth control" lest unnecessary forms and reports come into being. It must also review the forms and reports presently in use.

In considering forms and report control, certain tests should be applied to record activity:

1. Who may create records and who is responsible for approval of the form and form system?
2. Are records designed for effective use?
3. Are forms and reports standard as to size of paper, etc.?
4. Is distribution excessive — are all copies necessary?
5. Is the same information duplicated on other forms?
6. How are forms obtained and is this procedure effective and economical?
7. Do forms indicate which is to be the eventual record copy?

This early challenging of present forms and reports and continuous control over new ones must be an integral part of any record retention program. It is important to emphasize the continuity of control. A violent clearing out of records at sporadic intervals is most unwise since important papers are apt to be discarded. Any scheme, therefore, must be aimed at continuing efficiency and cost reduction. It is probably an understatement to say that the follow through of any program is as important as the development of it in the first place.

TRANSFER AND DESTRUCTION PROCEDURES

Any program of continuing control

must establish procedures for transfers of non-active records at the proper time and for destruction of non-active records which have served their purpose. One of its chief aims is a reclamation of storage space through the reduction of records and the release of active filing space for production use. Files and filing cabinets must indicate dates of transfer or destruction in order that a continuing flow from office to storage and storage to waste paper dealers etc. may be maintained.

After the inventory has been prepared it will be seen that it lists certain non-essential records which should be disposed of at an early date.

A complete listing of all records destroyed should be maintained and a suitable certificate of record disposal devised. Such a certificate should include a description of the items, form numbers, the method and date of disposal. It should also indicate who has authorized the disposal and should provide for a notarial certificate as indicated in the Canada Evidence Act if the material is of a type which may be required as evidence or which will now be kept by other means. The record of destruction then becomes a vital or important record which must be stored permanently and properly safeguarded.

STORAGE FACILITIES

If certain records are to be kept permanently they must be prepared on suitable paper and must be written in permanent ink. This should be particularly borne in mind for example when making entries in ledgers and journals or in the writing of contracts. More important, they should be kept in a location

which is protected from fire or other hazards.

We have discussed the "after-fire" value of records and indicated that this vitally affects the retention schedule because not only must there be a coding of records by period of retention but also by type of storage area in which the records should be retained. Coincident with the preparation of the inventory of records it is necessary to prepare a report on existing storage facilities in order to determine whether these are adequate or more than adequate and hence too costly for the type of records stored in them.

Vital records should be protected so that they will be safe even if the building or the section of it in which they are stored is completely burned out.

Important records should be given the same protection if at all possible.

Useful records should be housed in closed steel containers which are maintained with a minimum exposure to combustibles.

Non-essential records should be disposed of to reduce fire hazards. Certainly if they are retained they should be separated from more valuable records.

The survey of existing facilities must measure the hazards involved and then select adequate safekeeping equipment for retention of records. The majority of such equipment on the market bears underwriters' labels indicating certified performance.

Many companies today are placing fire insurance on those records or other documents which are vital in the operations of the going concern, e.g. accounts receivable ledgers. While such insurance provides a measure of protection it must be ful-

ly realized that many records are irreplaceable at any cost.

RECORDS RETENTION MANUAL

The final step for the records retention manager is the preparation and distribution of a comprehensive records control manual. This manual should cover every step of the procedure and anticipate most eventualities. It may consider the type of equipment to be used for storage and should outline the duties of personnel responsible for filing, controlling, storing and destroying documents. It will of course include a records retention schedule specifically designed for the company.

Conclusion

In conclusion the important steps in a proper records retention and control program are:

1. Formulating an overall plan under appropriate management supervision.
2. Any plan must include:
 - (a) An inventory and appraisal of existing records.
 - (b) A classification of all records by
 - (i) retention period

- (ii) protection to be afforded.

- (c) Institution of forms control.
- (d) The devising of transfer and destruction procedures
 - (i) when to destroy
 - (ii) when to transfer to storage
 - (iii) when to destroy, if ever, after transfer to storage
 - (iv) microfilming.
- (e) A survey of storage facilities and requirements.
- (f) Continuing control.
- (g) The completion of a records retention manual giving in detail the company's record keeping policies.
- (h) The training of employees in the continuing application of the program.

Records retention and control encompasses the supervision of all records from the time of creation to ultimate disposal or transfer to permanent storage on a *continuing* basis. It is designed to aid paper work procedures by the improvement of quality, reduction of quantity and resultant savings in cost. It is imperative in the maintenance of good business operations.

Administrative Accounting

MEASUREMENT OF PROFITS

The earning of a profit is a requisite for the continued existence of any company; the earning of a *reasonable* profit is a requisite for the successful operation of that company. If it is agreed that a profit is not only desirable but necessary, then management and the public need a yardstick to measure industry's profits, not in the absolute sense but in relation to their adequacy.

One of the most popular publicly used yardsticks is the relationship of profits to sales. The simplicity of this method is obvious and therein rests its greatest weakness. There are many types of industry today, ranging from ship-building and heavy construction to the manufacture of nails or the processing of foods, and the utilization of capital and manpower varies just as widely as the types of industry concerned. Some, such as food processing, depend on large sales volume with a relatively small percentage of profit on the sales dollar, while others have a lower volume of sales with a correspondingly higher percentage of profits. Yet measurement by this yardstick would appear to prove that one was relatively unprofitable compared to the other; or alternatively that one is fulfilling a useful need at a very modest cost whereas the other is victimizing the public as a whole for the benefit of a few. Is this really

the case? Perhaps, but the chances are that it is not. When analyzed it will probably be found that the industry with large sales volume and a low return on sales involves the performance of a rather simple function and comparatively little risk of loss of capital. On the other hand, most industries where the percentage return on the sales dollar is high require considerable technology and large investments in machinery and equipment. Thus the very fact that this method of measuring profits appears to be very simple constitutes its biggest danger. It does not provide a measurement that can be used indiscriminately for all types of business enterprise in today's complex economy.

Undoubtedly the most widely used measure of profits is total dollar profits. How often in the last few years have we read in the newspapers that such and such a corporation has earned all-time record dollar profits? Misleading as this is, many people have fallen into the trap of using it as a comparison. Record total dollar profits are simply a natural consequence of the present high level of national income and the unusually large expansion of productive facilities. They do not necessarily imply that industry is earning excessive profits, or even that it is using its resources with the greatest efficiency. It is possible that the best use of the

manpower, machinery and technology available would have produced higher profits and lower selling prices with the same volume of operations.

Profit per share of common stock is another widely used means of comparing results of operations because it so conveniently relates profits to the market price of the stock. It also permits shareholders to relate their earnings to other periods. It is not, however, an accurate measure of the achievements of the enterprise compared with other years, since additional capital may have been introduced in some other manner such as bank loans or a bond issue. Thus, a sharp increase in per share profits may result from expansion financed in some other way which has brought about a leverage factor in favour of common stock.

Neither can this yardstick be used as a basis of comparison with other companies in other industries, or even in the same industry. This, of course, is because of the differences which exist in capital structure. Obviously a company which has obtained a substantial portion of its capital by means of funded debt would have a different earnings per common share pattern than one which is financed purely and simply by the issue of common stock.

Another factor which can also create an artificial situation is a company's dividend policy. If one company has financed growth through the retention of past earnings, it may be that the common stock represents only a small part of the investment, whereas another company which has consistently paid out a large proportion of earnings as dividends has financed its growth by the issuance of additional common stock. Here a

comparison of earnings per share would present a completely misleading picture.

A third method of comparative measurement, profit as a percentage of net worth, does seem to overcome some of the objections to the two previous possibilities and to offer a useful and proper basis for such measurement. In fact, many authorities advocate this system above all others. It is argued that profits are produced by shareholders' money which is represented by capital and surplus, and that profits can be measured realistically only by relating them to net worth. Regardless of fairly wide usage, however, the rate of return on net worth is open to several serious reservations as a true indication of profit. While it does give an adequate measurement of the return on the shareholders' investment, it is by no means satisfactory as an overall indicator of the profitability related to the actual amount of money invested in operating assets as represented by plants, machinery and equipment, accounts receivable, inventories, etc. In fact, under some conditions, comparative results expressed as a percentage of net worth will result in a considerable exaggeration of a trend.

To be specific, the larger the proportion of a company's total capital obtained through borrowing, the smaller the net worth and the higher a given profit will appear when stated as a rate of return on net worth. Risks of trading with equity capital are, by the same token, enhanced, with the result that profits fluctuate more widely and are more likely to be converted at times into losses. Since methods of financing differ widely between industries and between firms, use of the net worth

ratio for comparison should be carefully considered in all cases.

There is another reason for regarding this method with caution. Net worth is not necessarily a direct measure of the original equity investment made by shareholders. It is adjusted as required to reflect losses, revaluations, and write-offs indicating investment mistakes which may have occurred. A corporation may show a high return on net worth simply because it has experienced losses during preceding periods and its net worth has consequently been reduced. Under these circumstances, it is difficult to consider that the owners are fortunate to be associated with an enterprise earning such a high return. In fact, the rate of return would be more criticism than praise of the results of operations.

From the foregoing examples and discussion, it seems that the first requisite for proper measurement of profitability is to develop some basis which is not affected by such factors as method of financing, type of industry, dividend policy, past earnings record and similar things. This, however, is much easier said than done. So far, the methods reviewed have related either to volume of business or to some particular portion of the investment used to earn the profit based largely on the source of the investment. What happens, then, if we ignore volume of business and the specific source of the investment? Surely the one common factor in all industry is investment, not just a portion, but total investment. There is no arguing the fact that profits should and do result from the demand for products as well as from the efficient use of plants, machinery and equipment and the current assets neces-

sary to operate the plants. The derivation of the money invested in these things is of no importance in measuring the efficiency of their use. It follows logically from this, that the total amount that an enterprise has in use and at risk is the total of all its operating assets, i.e. its gross current assets plus its gross fixed assets. That is the amount of money that the company has put to work and is risking in the business venture.

In the past, it has been generally accepted practice in determining investment to deduct current liabilities and certain reserves or allowances such as depreciation. But it does not seem logical to say that because part of the investment in operating assets has been supplied by the company's creditors or by means of reserves established by a charge against profits or surplus, it should be excluded from the calculation of the total amount of investment being used. After all, any loss is a loss to the shareholders, regardless of whether the money originally came from the net worth, from funded debt or a bank loan, or from the accumulation of reserves.

In any relation of profits to operating investment, there are also disadvantages. First, while the gross book value of fixed assets has been suggested as a measure of the investment involved, there are two factors which are not properly assessed under this procedure. These are the "economic loss" suffered on fixed assets through usage and the effect on book value or historic cost of the change in purchasing power of the dollar. For this purpose, it can be argued that fixed assets have dropped in value by the capitalized value of the reduction in efficiency as reflected in lower output and/or higher cost of production

caused either directly by higher operating cost, or indirectly by inability to adopt technological improvements in comparison with more modern units. To date, there does not appear to be any solution to the problem of calculating this loss. With respect to the fluctuating value of the dollar, again no accepted method of reflecting the changes has been developed. Still another area in which this method of measuring profitability leaves something to be desired lies in the fact that it does not give any weight to the value of goodwill, patents, trademarks, processes and the knowledge possessed by an efficient organization. Again it is a problem of determining the value of such intangible assets and to date, as in the case of "economic loss", no widely accepted and practical method for doing so has been developed.

The fact, however, that no acceptable solutions have been found for these problems should not prevent the use of a yardstick which, while not perfect, does eliminate many of the disadvantages of other forms of measurement. A return computed on the basis of net profit before deducting any interest on loans, related to gross investment, is the most practical measure of overall profits available and should enable shareholders and management to understand how profitably the total assets are employed.

So far, all the mentioned methods of measurement have been related to

total company profits. There are, however, many cases where some form of comparison is needed for internal use. The desirability of relating the profitability of various processes or product lines or plants or even specific machines is constantly arising. Time and space do not permit a full review of all the possibilities, but there are a few which deserve notice. One of the factors which always presents a problem is the use of out-of-pocket costs versus full costs. Again many problems arise in the justification of new investment particularly at established units or plants. There are several ways of relating the economics of this kind of investment, such as calculation of labour saving or determination of increased profit through an increase in production. Without measuring actual dollar effect it is often desirable to measure comparative labour efficiency. These, of course, are only a few of the possibilities; undoubtedly there are many more.

No review of this subject would be complete, however, without one overall word of warning. Each application of comparative measurement is an individual problem. Thus the greatest care should be exercised in the selection of a medium to ensure that the right one has been chosen. Company profits would likely not be measured in the same way when a labour contract is being negotiated as they would when a bank loan is being sought.

The Tax Review

THE TAXATION OF PARTNERSHIP INCOME

The basic rule of the Income Tax Act is that the income which is taxed is the income of a person, and as a partnership is not a person, it follows that there is no taxation of the income of a partnership as such. The members of a partnership are, however, persons and therefore taxable. It follows that if A, a Canadian resident, carries on a business wholly within the United States in partnership with B, who is not a Canadian resident, only A is chargeable to tax in Canada in respect of his income from the partnership business carried on in the U.S.A. (and entitled, of course, to the appropriate tax credit for U.S. taxes on the same income).

While it is clear enough that a partnership as such is not subject to income tax in Canada, the tax position of persons who carry on business in association with one or more other persons is not always free of problems. There are two main sources of difficulty: (1) Is the relationship of the taxpayer to his associate or his associates a partnership? (2) What is the income of a partner from a partnership?

What Is a Partnership?

The concept of partnership as it evolved in England and as it is now crystallized in the Partnership Acts of the nine common law Provinces is that *a partnership is the relation*

which subsists between persons carrying on a business in common with a view of profit. Note particularly that there is no necessity that a partner shall contribute capital, labour or skill to the partnership; it is necessary only that the business of the partnership be conducted on his behalf as well as on the behalf of the other partner or partners.

Note also that partnership is something different from common ownership of property, and this may be so even where there is an agreement between the common owners for the management of the property and the division of the profits. Nor does an agreement to share profits or profits and losses necessarily create a partnership, though admittedly it is pretty strong evidence in support of a partnership. On the other hand there may be a valid partnership between persons though, as between the partners, one of them is not liable to bear a share of partnership losses. Of course so far as persons dealing with the firm are concerned, a partner cannot avoid his responsibility to them whatever the agreement between him and his partner. Note also that the partnership relationship is a contractual relationship between the persons composing it and that they are as free to modify and amend the basis of their contract as any other contracting parties are entitled to do.

A recent Canadian case concerned with some of these questions is 41 v.

MNR, decided by Mr. Justice Cameron in the Exchequer Court of Canada in July, 1952. In that case A, B and C carried on business in partnership as patent attorneys under an agreement which provided that on the death of one partner the surviving partners would admit his widow to the firm at a stipulated share of the profits and that the widow should have no interest in the firm's assets upon her death. On the death of A his widow was admitted to the firm as so agreed, her share in the profits being fixed at \$8475, but she took no part whatever in the conduct of the firm's business. The Minister ruled that the widow was not a partner in fact and that the share of profits paid to her was not a proper deduction from the partnership income, the result being that the other partners were charged to tax on the moneys paid to her. The Income Tax Appeal Board (Messrs. Monet and Fordham) upheld the Minister chiefly on the ground that as the widow of A performed no service for the firm and was not held out as a partner to persons dealing with the firm she was not a partner in fact. Mr. Justice Cameron allowed an appeal, holding that the widow was in law a full member of the partnership albeit a dormant one. He noted that she was entitled to share in the firm's profits and was liable with her partners for the firm's losses. It was immaterial, he added, that she was not a patent attorney, contributed no capital to the firm, and took no part in the conduct of its business. Partners, he pointed out, are entitled to determine with whom they will carry on business as partners and the share to which each is entitled in the firm's income and are required to pay tax only on their respective shares of the

partnership income, not on the shares they have earned.

A few months later a somewhat similar case arose in Quebec, which is interesting for the light which it throws on a difference between a partnership in Quebec and a partnership in a common law Province. In the Quebec case, *71 v. MNR*, decided by Mr. Fisher in October 1952, the members of a partnership carrying on a wholesale ice cream business were three brothers who, by their father's will, were obliged to provide their mother an annuity of \$5200 a year as a condition of inheriting the father's estate. They met this obligation by taking their mother into their partnership, agreeing that she should be entitled to \$5200 a year out of the partnership profits in priority to any division of profits among the other partners, and that her share should be cumulative from year to year in the event of a deficiency of assets in any year. It was further provided that she should not be liable for any losses. The mother took an active part in the conduct of the business with which she was familiar and left a large portion of her share of the profits on deposit to be used as working capital of the firm. The Minister ruled that the mother was not a partner and charged each of the sons with his proportionate part of the profits paid the mother. On appeal to the Income Tax Appeal Board, however, the Minister's decision was reversed. Mr. Fisher said that the alleged partnership fulfilled the requirements of the Quebec Civil Code respecting partnerships. The mother, he said, brought skill and property to the partnership. For it appears that under Quebec law, unlike the common law, a contribution of "property, credit, skill or industry" is essential to

constitute a person a member of a partnership.

The Income of a Partner from a Partnership

The Income Tax Act declares that a taxpayer's income from a partnership for a taxation year shall be included in computing his income for that year whether or not he has withdrawn it during the year (sec. 6(c)). The Act does not, however, lay down any special rules for computing the income of a taxpayer from a partnership, and one must therefore look to the cases to see the type of problem that arises in this regard. A number of disputes have arisen in Canada on this question, of which as yet only one has reached the Exchequer Court. The question in all of these cases was the same, namely, under what circumstances an expense incurred by one partner is or is not deductible in computing his income from the partnership.

In *Biggar v. MNR* [1948] C.T.C. 43, a partnership agreement between three partners provided that the profits of a separate business carried on by A, one of the partners, should be brought into the law firm's accounts. In point of fact, however, A met certain personal obligations out of the profits of the separate business and only brought the balance of its profits into the law firm. To this the other partners consented. The Minister took the position that all of the profits from A's separate business were part of the profits of the law firm and assessed the partners accordingly. Mr. Justice Cameron allowed the appeal, holding that the partners were entirely free to abandon their right to share in the full profits from A's separate business, and that the sums paid by A out of

the profits of his separate business were never part of the income of the partnership in which the other partners had any beneficial interest.

This decision is in accord with the following provision of the Partnership Act:

The mutual rights and duties of partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing.

In the Income Tax Appeal Board the decisions have not been uniform on this question.

In *Hornbeck v. MNR*, 1 T.A.B.C. 245, decided in 1950, A, a member of a firm of retail florists, used his own car about the partnership business and met the expenses of operating his car out of his own pocket. The Minister ruled that these expenses were not deductible by him in computing his share of the partnership income on the ground that they were incurred not by the partnership but by him personally. The full Board rejected this view and permitted A the deduction.

A short time later, however, two of the Board's members reversed themselves in *I. v. MNR*, 2 T.A.B.C. 83. In that case A, a member of an accounting firm, was refused a deduction of certain expenses which the other members of the firm refused to recognize as proper expenses of the firm. It was not disputed that the expenses in question were expenses of the business and would have been deductible by A had he been carrying on business independently. The decision is therefore in direct opposition to that in the *Hornbeck* case.

In *Lafleur v. MNR*, decided by Mr. Monet in January 1951, a member of

a partnership which operated a tavern assigned one-half of his share of the profits to a creditor. The Minister nevertheless assessed him to tax on his entire share of the profits, i.e., without regard to the assignment. This was a Quebec case, and it may be that the law of partnership in that Province differs from that of the common law Provinces, but there would appear to be no doubt that in the common law Provinces an assignment of a share of profits from a partnership business does not by itself create a partnership between the assignor and assignee. Mr. Monet held, however, that such was the effect and that the assignor was only chargeable to tax on the share of the partnership profits which he actually received. The decision does not harmonize with the Board's decision in *I. v. MNR*.

In *F. v. MNR* (1950) 2 T.A.B.C. 99, three brothers carried on a retail business in partnership, from the profits of which they paid their sister an annuity of \$900 pursuant to the will of a deceased partner (their father). By a unanimous decision the Income Tax Appeal Board held that the partners were not chargeable to tax on the amount of the annuity; the Crown's contention that the annuity payments were mere applications of the partnership profits was rejected. The Board arrived at this conclusion by a somewhat unusual course of reasoning, viz, that the deceased partner's interest in the firm never vested in the three sons to whom he bequeathed it but was held

by them in trust. The fact nevertheless remains that the decision does not in result harmonize with the Board's decision in *I. v. MNR*.

In *Cooperberg v. MNR*, decided in September 1951, Mr. Monet followed *I. v. MNR* in refusing one partner a deduction for automobile expenses incurred by him in carrying on the partnership business, the ground of decision being that the expense was not an expense of the partnership.

A *contra* decision is that of Mr. Fisher in *Parkinson v. MNR*, decided in August 1951, where it was held that expenses incurred by A, a member of a law firm, in attending a lawyers' convention were deductible in computing A's income from the law practice notwithstanding that the expenses in question were paid by him personally and not charged to the firm. It made no difference, said Mr. Fisher in effect, that the expenses were paid by appellant out of his own pocket rather than out of the partners' joint account: if they were allowable in the latter case they were allowable in the former.

The result of all these decisions is that tax practitioners have no certain guide to point them the way in these partnership cases. It is most regrettable that the two members of the Board who heard the appeal of Mr. I in 1950 found it impossible to adhere to the view which the full Board had expressed only a short time earlier in the *Hornbeck* case. As a result there are now two lines of decisions pointing in opposite directions.

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Current Reading

MAGAZINE ARTICLES

ACCOUNTING

"PROFESSIONAL ACCOUNTANCY IN THE WORLD'S FOUR CORNERS," by Mary E. Murphy. *The South African Accountant*, December 1955, pp. 183-191.

Readers of this article should not be disturbed by Dr. Murphy's early reference to members of the Institute of Chartered Accountants of Scotland as 'the only practitioners in the world entitled to place after their names the initials C.A.'. For, drawing upon her extensive experience in the United Kingdom, Dr. Murphy has indeed packed a wealth of interesting material on British accounting developments into eight pages.

Dr. Murphy reports, among other things, that the Scottish Institute's Council has decided against issuing recommendations on accounting and auditing procedure to its members, having concluded that freedom of thought, expression and form of accounting statements is vital to professional development, and that complete trust should be imposed in the sound judgment of members to decide what should be done in any particular engagement.

She also notes that at December 31, 1954, membership in the Institute of Chartered Accountants in England and Wales stood at 18,152, of whom 7,215 were in public practice either at home or overseas.

Says Dr. Murphy: "Nationalization

... meant the introduction of uniform accounting and auditing standards, the loss of many long-held appointments by public accountants, and the introduction of the efficiency audit. . . . It was apparent from the beginning, that the attainment of efficiency in nationalized industry depended to a marked degree on the ability of the profession of accounting to develop the necessary techniques to meet the vast flood of information and to summarize it for public digestion. . . ."

BUSINESS EQUIPMENT

"THE HIGH-SPEED COMPUTER; DETAILED APPLICATIONS TO OFFICE WORK," by T. R. Thompson. *The Accountant*, March 24, 1956, pp. 319-323.

Mr. Thompson has determined from his own practical experience that there are six main essentials to successful computer application:

1. Start with the job, make sure what is wanted, and see if there is a computer that will do it. Never take a computer and then try to put jobs on it.
2. Get the true requirements of the job down completely and express them in a single sentence. Break the statement down step by step to obtain sufficient detail to know what to do, the volume and kinds of information to be handled, and an indication of the results that need to be produced.
3. Prepare an effective plan for the job to organize the flow of information to bring items of data together, taking into account when information becomes avail-

able and the order in which items are received.

4. Make sure it will be economical and effective before going on to the computer.
5. Get the job coded in a practical manner.
6. Get the cooperation of operating executives to ensure that the data is prepared in the right form and that the results produced are used properly.

In Mr. Thompson's experience, unsuccessful computer applications have always resulted from a violation of one or other of these six steps.

The application of computers to payrolls, inventories, factory production and cost control, and cost accounting are also discussed.

To accountants planning to enter the computer field Mr. Thompson offers the following advice: "... make sure that you get a proper course of training that leads you to a practical experience of planning jobs and putting them on to a computer. ..."

COST ACCOUNTING

"LUMBER COSTS, DIRECT VS. ABSORPTION," by Frank M. Carter, *Cost and Management*, February 1956.

Mr. Carter, whose company manufactures and sells forest products on a relatively small scale, has had an opportunity to evaluate both absorption costing and direct costing with reference to a lumber operation. On balance he finds direct costing to be the more satisfactory for the following reasons:

1. It simplifies daily accounting, resulting in lower costs, since fewer personnel and less supervision are required.
2. It facilitates budgeting and profit planning.
3. It improves management's understanding of the figures, and therefore enables management to utilize them more completely.

FINANCE

"HOW A CORPORATION RAISES CAPITAL. A report prepared by the Finance Management Committee, N.Y. City Control, Controllers Institute of America." *The Controller*, April 1956, pp. 155 et seq.

Most of the points made in this report will already be well known by qualified accountants. Student members, however, should find the material interesting and profitable reading. Eight methods of financing are first surveyed. This is followed by a discussion of forecasting cash requirements, preparing for a public offering, and relations with underwriters.

Two quotations of note:

1. "The capital structure of any company should be considered as something 'dynamic' rather than 'static' and the proportion of debt and equity should be considered in terms of an average over a number of years rather than at a given instant ..."
2. "... it is considered unwise to raise funds frequently in small amounts ... it [is] best to procure more than is required by issuing stock under favorable conditions rather than be forced to float another issue or raise funds in another manner within a relatively short period of time. ..."

MANAGEMENT

"FRINGE WAGES AND PRODUCTION COSTS." *Cost and Management*, February 1956, pp. 59-66.

In the greater part of this article, Professor Seiler, of the University of Texas, is concerned with analyzing the effect of supplementary wage payments upon comparisons of labour costs and the relationship of these new payments to production volume and the break-even point.

To bring the discussion into proper

focus, he first reports that in 1953 the fringe payments in U.S. industry averaged over \$722 annually per employee, or 19.2% of the employee's direct compensation. Such payments ranged from a low of 14.3% of payroll in the paper, lumber, and furniture industries to a high of 28.7% of payroll in banking.

Professor Seiler's theoretical analysis, fully illustrated by graphs, is designed to show that these indirect wage payments tend to form a U-shaped cost curve, thereby raising a company's break-even point and limiting it to a narrower range of production possibilities. This leads him to assert that stabilized employment, long sought after by unions, may, in fact, be in the employer's best interests too.

PROFESSIONAL

"REHABILITATING A SICK BUSINESS", by Clinton W. Bennett. *The Journal of Accountancy*, April 1956, pp. 50-53.

By the very nature of their work, medical practitioners soon became accustomed to making decisions on the basis of factual data that is sometimes incomplete. Mr. Bennett advises that in the rehabilitation of a sick business the professional accountant must also develop this facility. Be practical, he warns, for the owners of a business will not be impressed by a fine technical diagnosis if the patient has died in the meantime.

Employing a vocabulary liberally interspersed with medical terminology, the author leaves no doubt in the mind of his reader that the medical analogy is a close one. This similarity is further emphasized by the inclusion in the article of three case his-

tories on actual experiences with three sick companies.

In his discussion of the diagnostic technique Mr. Bennett suggests that four broad areas of business activity should be subject to searching scrutiny: manufacturing facilities, selling and merchandising procedures, management and economic aspects. While some of the problems that may arise within these areas would not fall within the accountant's province, the author believes that with his training and experience the independent accounting practitioner is particularly well equipped to alert his clients to unsatisfactory trends and to prescribe a rehabilitation program.

He concludes that neglect by the accounting profession of such an opportunity to render a true public service would be a tragedy.

TAXATION

"THE IMPACT OF THE NEW REVENUE CODE UPON ACCOUNTANCY", by A. H. Cohen. *The Accounting Review*, April 1956, pp. 206-216.

The 1954 Internal Revenue Code permitted U.S. taxpayers for the first time to accrue expenses and to defer income received in advance in the calculation of their taxable income. The Finance Committee of the U.S. Congress estimated that the new provision would reduce government revenues by about \$35 million. Taxpayers took such advantage of this provision, however, that some estimates place the impact on federal revenues as high as \$5 billion. The provision has since been repealed retroactively.

Mr. Cohen cites this case to illustrate the difficulty involved in attempting to conform tax accounting with generally accepted accounting principles. He asserts that the basic

motivations are different: accounting theory, with the determination of income for the purpose of assisting management and reporting to shareholders; federal taxation, with the production of government revenue, modified by social, economic, political, and other non-revenue motives. Since tax considerations so often seem to take precedence over the application of sound accounting principles, Mr. Cohen urges the accounting profession to review continually its own set of principles, to make sure that they are still appropriate to modern business.

BOOK REVIEW

Financial and Administrative Accounting, by C. A. Smith and J. G. Ashburne. McGraw-Hill Co., Toronto, 1955, pp. 493, \$8.50.

Have you ever tried to explain to someone not familiar with accounting the difference between spending money on capital items as against expense items? If so, you will understand the difficulty faced by the authors of this book in trying to explain the broad range of accounting and financial administration in words and graphs that the average student or non-accountant reader can understand. In covering broad concepts and principles, the authors have been forced to stay with rather broad reviews of many areas and, therefore, an accountant reader cannot expect to find precise detail in most of the general methods outlined.

The authors have clearly stated their purpose as "to present and explain the methods and philosophy of accounting and to suggest the uses of accounting data so that the non-accountant may derive the greatest benefit from the accountants' services

in his own area of work". To this may be added the intention for use of the book as a text as indicated by the inclusion of numerous questions after each chapter.

The practising chartered accountant can look to certain areas of the book for subjects of interest to him. The review of concepts basic to accounting and the section on analysis of financial statements form a valuable quick review and reappraisal for anyone who has not thought back to basics for some time. The definition and description of accounting periods and reasons for accepted practices are well set forth. Where an accountant discusses freely with his client such matters as organization, budgeting and systems, the sections of the book on these subjects may be of interest, although they tend to describe one general approach that might not fit easily in many companies. The authors state that they favour the use of purchasing power adjustments based on accepted indices in the accounts so long as the amount of adjustment is shown separately and not hidden. They believe that in time auditors will give their opinion on the appropriate nature of indices used and on the mechanical accuracy of their application.

The accountant in industry can look to this book as a valuable tool for reviewing his basic thinking and for use in instruction of new clerical personnel and those not normally familiar with accounting techniques. Of special value to the accountant is the section suggesting that a careful analysis of costs should be the starting point for determining what form the budget of a company should take. This approach is not commonly found

in text books. For those not familiar with accounting and financial organization, the book presents a picture of the ways in which accounting serves more than a mere financial history purpose.

The breadth of subject matter tackled by the authors in this book is staggering but they have done well in skimming the cream from each field covered.

F. W. HURST, C.A.

BOOKS RECEIVED

"The Administration of Health Insurance in Canada" by Malcolm G. Taylor, Oxford University Press, Toronto, pp. 280, \$5.00 (To be reviewed).

"Canada in World Affairs" by B. S. Keirstead. Published for The Canadian Institute of International Affairs by Oxford University Press, pp. 320, \$3.50.

"The Manual of Modern Business Equipment." The Office Appliance and Business Equipment Trades Association. Macdonald & Evans Ltd. (Publishers). Parts 5-8 of a manual in 25 parts. £5-5/-, or 4/6d each part.

"Income-tax for the Layman." Central Board of Revenue, Government of India, Delhi. pp. Rs 1/12/- (35c) (To be reviewed).

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"Depletion Records for Timber Operations," by J. H. O'Rourke. *N.A.C.A. Bulletin*, August 1955, pp. 1679-1688.

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"Accounting in Management," by Joel Hunter. *The Journal of Accountancy*, November 1955, pp. 62-65.

"Effective Reports for Sound Decisions," by D. S. Moffitt. *Dun's Review and Modern Industry*, July 1955, pp. 33 et seq.

Professional

"Ethics: The Profession on Trial," by Edward B. Wilcox. *The Journal of Accountancy*, November 1955, pp. 72-79.

"A Suggested Program for Cooperation Between Educational Institutions and Small Practitioners," by Charles Lawrence. *Accounting Review*, October 1955, pp. 645-650.

"Co-operation with the Client's Personnel," by Thomas J. Weis. *Arthur Young Journal*, April, 1955, pp. 28-30.

"Advisory Service: New Frontier," by Marquis G. Eaton. *The Journal of Accountancy*, November, 1955, pp. 56-61.

"Helping the Small Client with Budget Problems," by Thomas W. Leland. *The Journal of Accountancy*, October, 1955, pp. 56-61.

"Management Services by Local Practitioners," by Joseph L. Brock. *New York C P A*, September, 1955, pp. 520 et seq.

Addresses of Publishers

Accountancy (Eng.) Incorporated Accountants' Hall, 24 Temple Pl., Victoria Embankment, London, E. C. 2, Eng.

[The] *Accountant* (England), 4 Drapers' Gardens, Throgmorton Ave., London, E. C. 2, Eng.

Accounting Review, College of Commerce and Administration, Ohio State University, Columbus 10, O.

American Economic Review, Northwestern University, Evanston, Ill.

Controller, 2 Park Ave., New York 16, N.Y.

Cost of Management, 31 Walnut St. S., Hamilton, Ont.

Dun's Review and Modern Industry, 99 Church St., New York 8, N.Y.

Government of India (Manager of Publications) Civil Lines, Delhi 8, India.

Illinois Certified Public Accountant, 208 S. LaSalle St., Chicago 4, Ill.

Journal of Accountancy, 270 Madison Ave., New York 16, N.Y.

Macdonald & Evans Ltd., 8 John St., Bedford Row, W. C. 1, Eng.

NACA. Bulletin, 505 Park Ave., New York 22, N.Y.

New York Certified Public Accountant, 677 Fifth Ave., New York 22, N.Y.

Oxford University Press, 48 University Ave., Toronto 2, Ont.

[The] *South African Accountant*, P.O. Box 2826, Durban, S. A.

Students Department

*Associate Professor,
Queen's University*

NOTES AND COMMENTS

As we write these notes, a little over a month ahead of publication, we are experiencing our own special kind of April shower. It is a spring-time shower of annual reports, and our head nods drowsily to the soft patter of reports as they fall gently on our desk-top from sundry sources.

A few of these reports we receive in the most legitimate of all possible ways, by being a shareholder. Others come to us, we suspect, because they seem too expensive to throw away and those who bring them have heard that we keep a file of annual reports. And one or two reports usually come with the strong recommendation that we say something bitter about them in these pages — preferably, of course, identifying the offending companies or naming the auditors!

In the annual report of a chain of stores which has been expanding steadily we have underlined the president's statement that, "Consistent with the policy of your Company several stores were closed where the potential was considered inadequate for further profitable operation." This remark interested us because it seems to provide evidence that sometimes companies do expand operations rationally, only where the expansion will increase profits; or at least that they do not indulge in expansion merely for the sake of expansion.

Economic theory teaches, if we understand it correctly, that expansion is only profitable where the additional revenue will be greater than the additional costs. A chain of stores must provide a unique opportunity for comparing differential revenues and differential costs, because the cost and revenue data will be available store by store.

But we winced as we read, in another annual report, and auditors' report to the shareholders which included the words "and the results of their operations for the period ended on that date". We cannot forget the threats of accounting instructors in times past who delighted to picture what would happen to anyone who referred to "the period ended" without defining the period precisely!

The report of a large U.S. insurance company which has come to hand notes that the directors have been holding some of their meetings in different locations with key branch personnel present. This is a practice which has evidently been growing in recent years, and advantages are claimed for it from the point of view of both public relations and personnel relations.

We understand that some agitation has developed in the United States to have shareholders meetings, also, held in different locations from year to year, especially when the company

has a wide geographic distribution of shareholders. Company legislation in some of the States requires, however, that the shareholders meeting be held in the State in which the company was incorporated; and it is not possible in the United States, as it is in Canada, to incorporate an industrial or commercial company with nationwide operations under a federal Act.

Recent statistics are encouraging in that they indicate a definite swing away from the use of the word "reserve" as used in "reserve for depreciation", "reserve for bad debts", and "reserve for income taxes". The one

thing which we find discouraging, however, is that a few of our largest and most prominent companies are among those who persist in retaining this obsolete terminology. (A few even add insult to injury by grouping all or many of these "reserves" under a single heading on the right hand side of the balance sheet.) For those of us who find something aesthetic in published balance sheets, such a travesty of arrangement, and failure of artistic expression, brings great anguish of spirit; and we are left wondering why some companies must always mix a few very old flowers in their annual spring bouquet.

(Correspondence with readers is cordially invited)

PUZZLE

Re-arrange the figures in the squares below so that every horizontal, vertical, and diagonal line adds up to the same figure.

1	2	3
4	5	6
7	9	9

(Submitted by D. Nenson, Regina.)

The solution for this puzzle appears at the end of the Problems and Solutions.

SOME RECENT STUDENT HOWLERS

(Statements made by students-in-accounts in their exercises in the C.A. Course of Instruction)

"Preferred claims in bankruptcy are certain debts, e.g., the cost of executing creditors."

"The student-in-accounts must be neat in appearance and dress himself quietly."

"In ancient times individuals were not free to dispose of property as they pleased after their death."

"In order to reduce the authorized share capital, a meeting of the shareholders must be called to sanctify the appropriate by-law."

"A junior partner is one who is under 21 years of age."

"The dividing up of work provides a method of slowing down the stealing from the company."

"The offence of directors who declare dividends in excess of earnings is known as capital punishment."

"A qualified auditors' report is the report of qualified auditors."

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, October 1955

Accounting I, Question 3 (15 marks)

ABC Co. Ltd. acquired its first fixed assets on 1 Jan 1952 and has consistently employed the following method of accounting for fixed assets and the related depreciation.

- (i) All depreciable fixed assets are included in one account called "Depreciable Fixed Assets". The cost of additions are charged to this account; the proceeds of disposals are credited to it.
- (ii) Annual charges for depreciation have not been accumulated in separate accounts, but have been credited directly to the "Depreciable Fixed Assets" account. Depreciation has been provided since 1 Jan 1952 at a rate of 20% on the balance in the "Depreciable Fixed Assets" account at the end of each year.

The directors of ABC Co. Ltd. have asked you to calculate what the profits before income taxes would have been for the past three years, if a straight line method of providing depreciation had been used at a rate of 10%

on closing balances each year. They would like to have profits or losses on disposals of fixed assets reflected in the revised profit figures.

You ascertain the following information:

(i) Profits before income taxes, as calculated by the company were:

1954.....	\$175,000
1953.....	180,000
1952.....	200,000

(ii) The balance of the depreciable fixed assets account at 31 Dec 1954, after providing depreciation for the year, was \$317,680.

(iii) Additions at cost were:

1954.....	\$130,000
1953.....	48,000
1952.....	20,000

(iv) Details of disposals were:

<i>Year Sold</i>	<i>Cost</i>	<i>Proceeds</i>	<i>Date Acquired</i>
1954	\$38,000	\$32,700	1st January 1952
1954	25,000	25,000	1st June 1953
1953	75,000	55,200	1st January 1952
1952	4,000	3,500	1st January 1952

Required:

Statement of the revised figures of profits before income taxes for 1952, 1953 and 1954, which you would submit to the directors of ABC Co. Ltd. together with schedules setting out your computation of the revisions to the figures for profits before income taxes as calculated by the company.

A SOLUTION

ABC CO. LTD.

STATEMENT OF REVISED PROFITS for years 1952 - 1954

	<i>1952</i>	<i>1953</i>	<i>1954</i>
Profits before income taxes, per company	\$200,000	\$180,000	\$175,000
Add back: depreciation calculated on diminishing balance basis at 20% (per Schedule A)	103,300	81,200	79,420
	<u>\$303,300</u>	<u>\$261,200</u>	<u>\$254,420</u>
Less: depreciation calculated on the straight line basis at 10% (per Schedule B)	51,600	48,900	55,600
	<u>251,700</u>	<u>212,300</u>	<u>198,820</u>
Profit or losses on disposal of fixed assets	(500)	(12,300)	4,800
Revised profit before income taxes	<u>\$251,200</u>	<u>\$200,000</u>	<u>\$203,620</u>

STUDENTS DEPARTMENT

531

SCHEDULE A

Balance, Depreciable fixed assets 31st Dec 1954	\$317,680
Add: Depreciation claimed in 1954	79,420
Disposals — proceeds	57,700
	<u>\$454,800</u>
Less: Additions — at cost	130,000
	<u>\$324,800</u>
Balance Depreciable fixed assets 31st Dec 1953	\$324,800
Add: Depreciation claimed in 1953	81,200
Disposals — proceeds	55,200
	<u>\$461,200</u>
Less: Additions at cost	48,000
	<u>\$413,200</u>
Balance Depreciable fixed assets 31st Dec 1952	\$413,200
Add: Depreciation claimed in 1952	103,300
Disposals — proceeds	3,500
	<u>\$520,000</u>
Less: Additions — at cost	20,000
	<u>\$500,000</u>
Balance Depreciable fixed assets 1st Jan 1952	<u>\$500,000</u>

SCHEDULE B

	Fixed Assets	Depreciation	Proceeds	Profit or (loss) on sale of assets
Balance 1st Jan 1952	\$500,000			
Additions 1952 — at cost	20,000			
	<u>\$520,000</u>			
Disposals 1952 — at cost	4,000		\$ 3,500	\$ (500)
	<u>\$516,000</u>			
Balance 31st Dec 1952 ..	516,000 @ 10% = 51,600			
Additions 1953 — at cost	48,000			
	<u>\$564,000</u>			
Disposals 1953 — at cost	75,000	(7,500)	55,200	(12,300)
	<u>\$489,000</u>			
Balance 31st Dec 1953 ..	489,000 @ 10% = 48,900			
Additions 1954 — at cost	130,000			
	<u>\$619,000</u>			
Disposals 1954 — at cost	63,000	(10,100)	57,700	4,800
	<u>\$556,000</u>			
Balance 31st Dec 1954 ..	\$556,000 @ 10% = 55,600			
	<u>\$500,400</u>			
Net loss on sale of fixed assets for the three years				<u>\$ 8,000</u>

PROBLEM 2*Final Examination, October 1955*
Accounting I, Question 2 (20 marks)

In calculating the 1954 taxable income of an individual under the Income Tax Act, indicate how and to what extent each of the following unrelated items should be taken into consideration:

- (a) In December 1954, an employee received a loan of \$3,000 from a limited company in which he was a shareholder. The money was not repaid to the company on 31 Dec 1954. The money was used to purchase from the company fully paid shares of the company to be held by him for his own benefit. Bona fide arrangements were made at the time the loan was made for its repayment within a reasonable time.
- (b) An individual is employed by a concern which has an approved pension plan. During 1954, a total of \$1,600 re current service contribution and a total of \$800 re past service contribution were deducted from the individual's salary.
- (c) An individual owns an apartment house in which he occupies one of the apartments, rent free. During 1954, the net rental income from the apartment building was \$5,500. This figure was made up: rentals received \$22,000, less repairs and wages \$9,000 and capital cost allowance \$7,500. All apartments are similar and the annual rental of each was \$2,200.
- (d) An individual owns several hundred acres of land which he leases to local farmers. During 1954, he suffered a loss on this land of \$550, representing the net of taxes and sundry expenses less rentals received. In addition, the individual suffered a loss of \$4,000 on the 1954 operation of his own farm. This loss represents the net of taxes and sundry expenses less revenue from sale of produce. In arriving at the net operating figure from his farm, the individual had included \$3,000 capital cost allowance in respect of his farm equipment and buildings. Neither of these projects are the chief source of the individual's income.
- (e) In 1954, an individual paid \$65 as his contribution under a group hospital plan for himself, his wife and dependent child. During 1954, he paid the following medical expenses and has receipts therefor:
 - (i) \$300 to a doctor in connection with his illness.
 - (ii) \$450 to a registered nurse to attend upon him during his illness.
 - (iii) \$400 to a hospital in connection with his illness, covering charges not paid under the hospital plan.
 - (iv) \$500 to a doctor in connection with his son's illness.

The group hospital plan paid hospital charges totalling \$550 in connection with his illness and \$200 in connection with his son's illness. The individual's net income for 1954 was \$12,000.

- (f) An individual owned 2,000 shares of the Q Co. Ltd. On the winding up of the company as at 31 July 1954 he received \$40,000 as his share of the assets of the company. As of 15 July 1954, the Q Co. Ltd. had \$400,000 cash on hand, having converted all its assets into cash and liquidated all its liabilities. The capital stock of the Q Co. Ltd., \$300,000, was made up of 20,000 no par value shares. The balances in the earnings retained for use in the business account and the capital surplus account as at 15 July 1954 were \$80,000 and \$20,000 respectively. The undistributed income on hand for tax purposes was \$85,000.
- (g) In August 1954, an individual received \$3,150 from the X Co. Ltd. The payment resulted from the redemption of the company's preferred stock at a premium of 5%. The individual had purchased the shares at par.
- (h) An individual paid \$595 to the Income Tax Department during 1954 as a result of the final assessment of his 1952 income taxes. This amount was made up of \$495 additional tax with \$100 for interest thereon.
- (i) An individual had deducted \$700 as depreciation on his office building in determining his net income for 1954. According to his records, a new furnace had been installed during the year at a cost of \$500. The old furnace, which was sold to a junk dealer for \$50, had originally cost \$400 against which \$250 depreciation had been accumulated. According to the individual's 1953 tax return, the undepreciated capital cost of the building (including the heating components) as at 1 Jan 1954 was \$15,000. The building falls in the category of class 3 assets (5% for income tax purposes).
- (j) During 1954, an individual contributes \$500 to the support of his mother. She has an annual income from government bonds and old age pension of \$760. The individual's taxable income taking into account a marital exemption but before considering the above possible exemption is \$7,000.

A SOLUTION

- (a) The loan of \$3,000 need not be included in income. Section 8(2) excludes this type of benefit from income.
- (b) The individual may deduct from his income a total of \$2,300 being \$1,500 for current services and \$800 for past services. Section 11(1)(i) permits a deduction of not more than \$1,500 in respect of current services and past services respectively, if actually paid.
- (c) The net rental income must be increased by adding back a portion of the expenses which are considered to be laid out for the individual's own apartment, as follows:

Rents received	\$22,000
Rent imputed to owner	2,200
Total	<u>\$24,200</u>
Proportion of total imputed to owner	<u>1/11.</u>

Net rental income	\$5,500
Add back portion of expenses disallowed:	
1/11 of repairs and wages	818
1/11 of capital cost allowance	682
Income to be reported	<u>\$7,000</u>

- (d) He may deduct $\frac{1}{11}$ his farming loss before capital cost allowances or \$5,000, whichever is the lesser. He may therefore deduct $\frac{1}{11}$ of (\$4,000 - \$3,000), that is \$500. He may also deduct the loss of \$550 from leasing land.
- (e) The \$65 is not allowed as a deduction from income. The taxpayer may, however, claim medical expenses to the extent that they exceed 3% of his net income with a maximum of \$1,500 for himself and \$500 each for his wife and dependents (limit of four dependents).

His deduction is therefore calculated as follows:

Medical expenses:	
Doctor	\$ 300
Nurse	450
Hospital	400
Doctor for son	500
Group hospital payments	
- self	550
- son	200
	<u>2,400</u>
Less 3% of net income	360
Amount to be claimed	<u>\$2,040</u>

- (f) The individual is deemed to have received a dividend to the extent of his portion of the undistributed income on hand, which is to be included in his investment income. This is calculated as follows:

$$\frac{2,000}{20,000} \times \$85,000 = \underline{\underline{\$8,500}}$$

- (g) None is taxable in the hands of the recipient. Section 6(g).
- (h) The individual may not make any deduction from his income for this payment as interest on taxes is not an allowable expense.
- (i) The capital cost allowance that can be claimed is calculated as follows:

Undepreciated capital cost at 1 Jan 1954	\$15,000.00
Additions, at cost	500.00
	<u>15,500.00</u>
Proceeds from disposal	50.00
	<u>15,450.00</u>
Capital cost allowance - 5%	772.50
Undepreciated capital cost 31 Dec 1954	<u><u>\$14,677.50</u></u>

The individual may claim an additional \$72.50 in calculating his income because the capital cost allowance is not dependent upon the amounts written in the books.

- (j) The individual could claim \$400 deduction by adding \$10 to his tax.

PROBLEM 3

Final Examination, October 1954

Auditing II, Question 4 (20 marks)

C, a retail merchant, applies to the bank for a substantial loan to finance inventory purchases, offering to pledge accounts receivable and investments as security. The bank asks CA to conduct such examination as he considers necessary and to prepare statements for their use in determining the extent they will extend credit to C.

C has been in business for three years and, although he maintains satisfactory accounting records, he has never had an audit.

Required:

- (8 marks) (a) Discuss in general terms the scope of CA's examination.
(12 marks) (b) What information, including statements and schedules, should CA prepare for submission to the bank?

A SOLUTION

(a) The Scope of CA's Examination

- (1) CA should make a complete verification of the balance sheet accounts. The check should be sufficiently extensive to permit him to form an opinion about the accuracy of the profit and loss accounts for the past three years.
- (2) CA should examine the trends indicated in the accounts to determine whether the business is showing a steady growth and whether it offers reasonable security for the repayment of the loan.
- (3) In view of the fact that the loan has been requested to finance inventory purchases, he should check the monthly inventory figures to ascertain the cause of significant variations, if any, and to ensure that the rate of inventory turn-over is reasonable.
- (4) CA should enquire into C's basis of granting credit to customers, his collection policy, and the relationship of outstanding accounts receivable to sales.
- (5) CA should scrutinize the investments to ascertain the extent to which they comprise speculative securities;
- (6) He should ascertain the methods of financing previously employed by C, and the reason for C's current request for a bank loan.
- (7) CA should enquire into the future prospects of C's business, the demand for its product, the state of competition, and the possibility that sales may be expanded.

(b) The Information which CA should Prepare for Submission to the Bank

- (1) An outline of the work which CA has done.
- (2) A balance sheet, preferably including the financial position at the close of the two preceding years.
- (3) A statement of profit and loss with comparative figures for the current and two preceding years.
- (4) A statement of source and application of funds for the three years.
- (5) An aged trial balance of accounts receivable, including C's comments as to their collectibility.
- (6) An investment portfolio, including the market value of the various securities.
- (7) A schedule of inventories grouped to show the classes which are seasonal or slow-

moving, if any, the method of determining the dollar amounts, and the provision for obsolete stock.

- (8) A list of the liens and mortgages existing against the assets.
- (9) A schedule of creditors.
- (10) A statement of the future prospects of C's business.
- (11) The possible terms for repayment of the loan.

PROBLEM 4

Final Examination, October 1955

Auditing I, Question 2 (18 marks)

Your firm has been appointed auditors of A Manufacturing Co. Ltd. Prior to the drafting of an audit program, the senior in charge of the audit instructs you to review the system of internal control relating to the purchases of raw materials and payments therefor. The company has both a receiving and purchasing department.

Required:

List the points to be covered in a questionnaire for the evaluation of the internal control over raw materials purchases and the payments therefor.

A SOLUTION

A MANUFACTURING CO. LTD.

QUESTIONNAIRE FOR THE EVALUATION OF INTERNAL CONTROL OVER RAW MATERIALS PURCHASES AND RELATED PAYMENTS

Purchasing Department

1. Is the purchasing department divorced from:
 - (i) the accounting department
 - (ii) the receiving department
 - (iii) the shipping department?
2. Does the purchasing department receive properly authorized purchase requisitions for all orders placed?
3. Are all purchases made on purchase orders?
4. Are purchase orders prenumbered and are all numbers accounted for?
5. Are all purchase orders properly authorized?
6. How many copies of the purchase order are prepared, and how are they disposed?
7. Does a copy of the purchase order go directly to the accounting department?
8. Does the purchasing department preserve a record of the receipt of goods by the receiving department, showing the date, quantities, shortages, damage claims?
9. Does the purchasing department receive a copy of the receiving report? Is this copy checked to the purchase orders?
10. Is an adequate record kept of uncompleted purchase orders and commitments for future purchases?
11. Are all substantial orders required to be placed on the basis of competitive bids or published discount sheets?
12. Is a system of perpetual inventory control maintained?

A SOLUTION

Receiving Department

1. Is the receiving department divorced from:
 - (i) the accounting department
 - (ii) the shipping department
 - (iii) the storekeeping department
 - (iv) the purchasing department?
2. Is an independent count and examination of the goods made by the receiving department as the goods are received, and checked to the shipping advice included with the shipment?
3. Are the details of the quantity and condition of the goods received recorded on serially prenumbered receiving reports and are all numbers accounted for?
4. How many copies of the receiving report are prepared, and how are they disposed? Does one copy go to the purchasing department to be checked against the purchase order?
5. Are goods received held by the receiving department until the purchasing department clears them for putting into stock?
6. Are there provisions for an immediate re-check of discrepancies between quantities ordered and quantities reported as received?
7. Does the receiving department maintain a permanent record of material received and shortages?
8. Are claims arising out of discrepancies made promptly?

Accounting Department

1. Do suppliers' invoices go directly to the accounting department?
2. Are invoices checked in the accounting department against:
 - (i) the purchase orders
 - (ii) the receiving reports?
3. Is there definite responsibility for checking invoices as to:
 - (i) prices
 - (ii) extensions
 - (iii) freight charges?
4. Do the procedures ensure that customers and employees are charged for merchandise purchased for direct shipment to them?
5. Is the distribution of charges reviewed in the accounting department by someone competent to pass on the propriety of the distribution?
6. Are returned purchases accounted for?
7. Do procedures ensure the filing of claims against carriers for shortages of damaged material?
8. Are invoices (vouchers) reviewed for completeness of supporting documents and checked and approved by a responsible official for payment?
9. At the time of payment are the invoices and supporting documents satisfactorily cancelled by or in the presence of the cheque signer to prevent their re-use to support duplicate payments?
10. Are received cheques delivered direct to the mail room by the last cheque signer?
11. Are the cheques signed by two people?

12. In preparing the cheques, is it a part of the routine to watch for the discount date?

SOLUTION TO PUZZLE

4	9	2
3	5	7
8	1	6

Timetable of October 1956 Uniform Examinations

The Board of Examiners-in-Chief gives notice that the 1956 examinations of the Institutes of Chartered Accountants in Canada will be written according to the following timetable. The morning sessions will be from 9 a.m. to 1 p.m. and the afternoon sessions from 2 p.m. to 6 p.m.

Wednesday, 10th October

Morning session — Final Accounting I

Afternoon session — Intermediate Accounting I

Thursday, 11th October

Morning session — Final Accounting II

Afternoon session — Intermediate Accounting II

Friday, 12th October

Morning session — Final Accounting III

Afternoon session — Intermediate Auditing I

Monday, 15th October

Morning session — Final Auditing I

Afternoon session — Intermediate Auditing II

Tuesday, 16th October

Morning session — Final Auditing II

Wednesday, 17th October

Morning session — Final Auditing III

NEWS OF OUR MEMBERS

Alberta

Nash & Nash, Chartered Accountants, announce the opening of an office at The Anglo American Bldg., 330 9th Ave. W., Calgary, with W. Robert H. Nash, C.A. as resident partner.

British Columbia

Irving G. Chertkow, B.A., C.A. announces the removal of his offices to Ste. 1220-1224 Vancouver Block, 736 Granville St., Vancouver.

Ackley, Nelson & Sandberg, Chartered Accountants, announce the removal of their offices to 1295 Kingsway, Vancouver.

New Brunswick

David Reevey, C.A. has been re-appointed president of the Saint John Family Welfare Association.

W. W. B. Dick, C.A. and F. P. Blackmore, C.A. appeared on a panel group to discuss the budget over radio station C.K.C.W., Moncton.

Ontario

D. R. Keedwell, C.A. has been appointed vice-president of Rapid Grip and Batten Ltd., Toronto.

E. P. Allison, C.A. has been named secretary and treasurer of Peek Frean (Canada) Ltd., Toronto.

N. E. Butler, secretary-treasurer of Fleet Manufacturing Ltd., Fort Erie, announces the appointment of D. Robert Gilmaster, C.A. as comptroller.

W. H. Flynn, C.A. has been appointed treasurer of Canadian Industries Ltd., Montreal.

G. H. Ward, C.A. announces the removal of his office to 200 Bay St., Toronto.

Sydney Morris, C.A. announces the removal of his office to 1590 Ouellette Ave., Windsor.

Colgate-Palmolive Ltd. announces the appointment of W. S. Winter, B.Com., C.A. as office manager and assistant secretary.

Ross O. Holditch, C.A. has been appointed treasurer of Union Carbide Canada Ltd., Toronto.

George M. Morrison, F.C.A. has graduated from Emmanuel College of Victoria University, University of Toronto, with a Bachelor of Divinity degree winning the post-graduate fellowship of one year's study abroad. He plans to study at St. Andrew's University in Scotland.

Quebec

George T. Donohue, president of Donohue Bros. Ltd., announces the election of A. Emile Beauvais, C.A. as vice-president.

Fred Phillip Levine, C.A. announces the opening of an office for the practice of his profession at 2112 St. Hubert St., Montreal.

W. Alex Falconer, B.Com., C.A. announces the opening of an office for the practice of his profession at Ste. 65, 417 St. Peter St., Montreal.

Bringloe, Watt & Co., Chartered Accountants, 407 McGill St., Montreal announce the admission to partnership of Donald W. Cook, B.Com., C.A.

George F. Abbott, C.A. announces the removal of his office to the Mutual Life Bldg., 627 Dorchester St. W., Montreal.

The editor welcomes information for this column. News of members and provincial Institutes' activities should be received by the 14th of the month to appear in the following issue of the journal.

INSTITUTE NOTES

ONTARIO

Election of Fellows — The Council has elected 46 members as Fellows of the Institute in recognition of their distinguished service to the profession. The members elected are:

E. H. Ambrose, R. D. Armstrong, E. H. Banks, H. E. Brown, T. M. Chase, P. T. Clark, F. R. Crocombe, R. B. Dale-Harris, D. B. Davis, C. J. Dick, H. C. Dixon, B. I. England, N. B. Gerry, J. W. Glendinning, G. H. Glennie, D. L. Gordon, J. S. Grant, W. L. Hogg, G. A. Kilner, E. D. Lafferty, K. W. Lemon, H. A. Lever, A. J. Little, J. J. Macdonell, G. A. MacDougall, L. G. Macpherson, J. A. McColl, N. B. McLeod, H. H. Milburn, L. J. Mills, G. Y. Ormsby, C. H. Pettit, C. F. R. Plummer, W. G. B. Read, K. L. Reid, W. S. Rothwell, H. A. Scarff, D. H. Shepard, W. A. Simonton, J. E. Smyth, M. S. Sutherland, J. C. Taylor, J. M. Thompson, T. Weir, J. S. Whitehead, C. E. Winters.

This election brings the number of F.C.A.'s to 152 out of 2670 members.

Annual Conference, Kingston, 1956 — A program and registration form for the Kingston Conference was sent to all members on April 30. By May 14, 61 registration applications had been received. An attendance of between 200 and 300 members is anticipated.

Municipal Auditors — The chairman of the Committee on the Accounts and Audits of Municipal and Certain Other Organizations met with officials of the Department of Education of Ontario, and it was decided that municipal auditors will be relieved of the duty of certifying the detailed lists of teachers' salaries effective with 1956 salaries reported on in 1957. The auditor, however, will still be required to report on the total of the teachers' salaries.

ONTARIO STUDENTS' ASSOCIATION

Study Groups — The Study Groups Committee is planning meetings for September and early October again this year. The intermediate and final groups will be basically along the established pattern but it is intended to increase the number of primary groups from three to approximately six and to get away from the idea of simply reviewing prior years' examination papers. What will be aimed at will be coverage in the six lectures of the main themes of the first year course in accounting, auditing and law. Lecturers will be hired and a small nominal charge will be made for those wishing to attend.

Sports Day — The annual golf tournament will be held at Rouge Hills Golf Club just east of Toronto on June 7.

Annual Meeting — This was held in the C.A. Building on Tuesday, May 15. The president, Tracy Lloyd, reported on the activities of the Association.

Ford Tour — Although the Students' Council had some early misgivings about an industrial tour, the event attracted 130 C.A.'s and students, and had to be split up over two nights, May 1 and 3.

QUEBEC STUDENTS' SOCIETY

A meeting to welcome those who have joined the Quebec Students Society since January 1955 was held on April 20. Guest speakers were W. S. Munro and Lucien D. Viau, president and vice-president, respectively, of the Quebec Institute. A film entitled "Accounting, the Language of Business" was shown and then C. D. Mellor, the Institute's executive secretary, led the gathering on a conducted tour of the new C.A. building.

The Students Society has arranged for a golf day at the LaSalle Golf & Country Club on June 7.

SWEETNESS AND LIGHT

It was a balmy day in Daytona Beach, but to a short thick-set man sitting inside a small bar on Orange Street it might as well have been raining cats and dogs. If he had turned his head to the left he would have seen a row of royal palms swaying in the warm ocean breeze. If he had even glanced to the right he might have caught the carefree conversation of a few tourists along the bar who had dropped in for a noon-hour pint. As it was, he just sat and stared straight ahead, his fingers clenched around a cocktail glass. When the bartender came past he pushed the glass forward and asked for another Martini. Then drawing in a deep breath, he said: "You don't happen to know a dentist around here, do you?" phrasing the gloomy question to invite a negative answer.

"Yes", replied the bartender, "but none of the dentists around here will take you without an appointment. What's the matter, got a toothache?"

"Yeah, a tooth that has been filled and refilled." He shuddered at the memory of past pain and then downed his Martini in a gulp. "Better give me another — make it double."

The bartender obliged.

"If you need a dentist I know a good one over on the peninsula. He'll take you right away — you may have to wait in his office a little while, but he'll take you. I go to him all the time and boy, how he goes at it with that drill. And if the tooth's no good he doesn't waste your money

trying to fill it. He just gives one good yank with the forceps and out she comes."

The man had been sipping his double rather slowly but nonetheless at the word "yank" began to choke.

"Doesn't he even freeze it first?" he asked almost in a whisper.

"Oh, yes, always", answered the bartender. "After the first jab you don't feel a thing. Why don't you go over and see him right now? His name is Dr. Stone and he's on South Atlantic just below Main Street."

"Well, on second thought", said the man, "I don't like them needles. They give me the creeps. I'd rather just have a few Martinis before I go. Better give me another one."

The bartender refilled his and a few other orders.

"You say this fellow is a good dentist?" asked the man.

"Absolutely."

"And there's no dentist around here?"

"Sure, there are dentists up the street, but they only work by appointment. If you go over to Dr. Stone he will do something to your tooth right away. One of the others might not take you for several days."

"Hmmm, I think I will take my chances around here", he sighed with the relief of a man who has just manoeuvred himself out of a delicate situation. He polished off two more Martinis and then put on his sun vizor. "Guess I'll go over and have a snooze in the park now."

"Hope your toothache doesn't bother you too much", called the bartender.

"Toothache? Oh, that's all gone. My teeth feel fine, just fine", and he glided out the door. JEAN VALE

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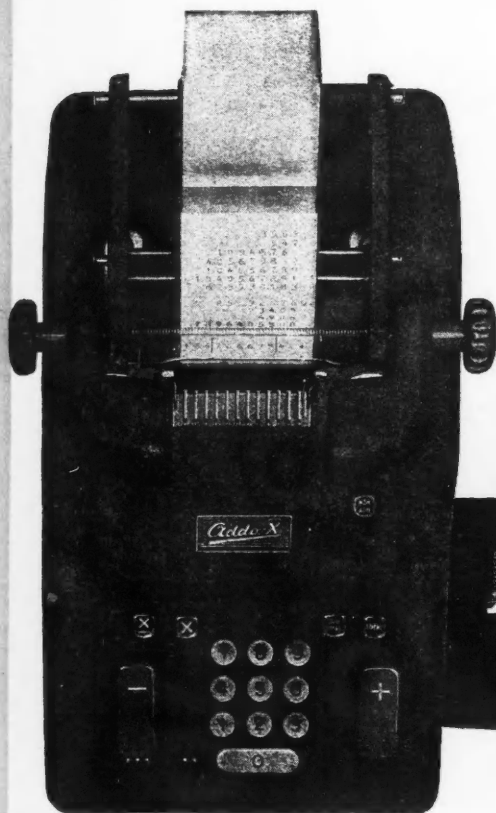
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14



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